Brown-Forman Corporation, Q2 2025, Earnings Call 2024-12-05

Presentation

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to the Brown-Forman First Half Fiscal 2025 Earnings Conference Call. — ***Operator Instructions*** —

At this time, I would like to turn the conference over to Ms. Sue Perram, Vice President and Director of Investor Relations. Ma'am, please begin.

Susanne Perram

Thank you, and good morning, everyone. I would like to thank each of you for joining us today for Brown-Forman's Second Quarter and First Half of Fiscal Year 2025 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 second quarter and first half of fiscal year 2025, 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 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 are 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.

Before we transition to our results, we have two very special guests with us. As you may recall, on November 25, we announced a change in our Board of Directors' Chair. Here to speak about this upcoming transition is Campbell Brown, Brown-Forman, Chair of the Board, and his successor, Marshall Farrer, Executive Vice President and Chief Strategic Growth Officer and Brown-Forman Board Director. Both are great, great grandsons of the company's founder. Campbell and Marshall have a few remarks they would like to share. After that, we will review our financial results, and then Lawson, Leanne and I will be available for Q&A. Campbell, I would now like to turn the call over to you.

Campbell Brown

Thank you, Sue, and good morning. I'm delighted to join you today as this is just the second time I have spoken on one of these quarterly calls. The first time was the third quarter of fiscal 2021 when it was announced that I would become the next Chair of the Board. Like then, I'm here today to discuss succession planning. As we know, it is not by chance that Brown-Forman has been a family-controlled organization for 154 years. Rather, we understand the company's independence has been enabled by intentional family connections generations as well as purposeful and productive relationships between the family

Brown-Forman's executive leadership team and Board of Directors.

As you may have seen at the recent meeting of the Brown-Forman Board of Directors, I announced my decision to step down as Chair when my term ends in July 2025. While this decision may have come as a surprise to some, let me assure you that even before assuming the role of Board Chair in 2021, I knew that my time in the position would be thoughtfully measured. My time line was always well aligned with our Board succession planning process, at the same time, being true to who I am and what I believe is best for the company that I love so dearly.

While I am stepping down from my role as Chair, I am thrilled to have the opportunity to stand for reelection in July as a Board member and continue to help Steward Brown-Forman's future in that capacity. It has been an honor to serve as Chair of the Board alongside such a talented collection of directors and a dedicated executive leadership team, but most of all, I continue to be impressed by the skill, dedication and resilience of our employees.

Since I became Chair, the role has served to reinforce everything I've known to be true and special about Brown-Forman. I am immensely proud of our committed and united family shareholders, the strength of Brown-Forman's people, culture and brands and our strong governance foundation and process. Individually, these are attributes any company would envy. Combined, they all but ensure Brown-Forman's continued success and independence as a resilient, family-controlled, publicly traded company guided by our core values and long-term perspective for generations to come.

And so it is with great pleasure that I also share that the Board has unanimously approved my successor and my cousin, Marshall B. Farrer, who will assume the role of Chair of the Board following his reelection to the Board at the 2025 Annual Meeting of Stockholders. Marshall will become the 11th Brown family member and third fifth-generation family member to serve in this important capacity. As Chair, Marshall will leverage his unique experience, both from within the company and as a champion of the family governance structure to continue to uphold our family's commitment to the long-term perpetuity of Brown-Forman. He has the global mindset, the industry network, the strategic acumen to guide our Board of Directors in stewarding Brown-Forman's growth and independence. Marshall is well prepared and ready to take on this role.

As a member of the Board and executive leadership team, he has partnered with Lawson Whiting, our CEO and the Board on its long-term strategy. I have full confidence in Marshall's ability to lead the Board and the family. He will continue to build upon and strengthen the relationships and legacy that have made and will continue to make Brown-Forman an independent world-class spirits company headquartered in Louisville, Kentucky, worthy of your long-term investment.

Please join me in congratulating Marshall and wishing him the best in this exciting step in his career and service to Brown-Forman. With that, I'll hand it over to Marshall.

Marshall Farrer

Thank you, Campbell, and hello, everyone. First, I'd like to thank the Board for the confidence it is placing in me as the next Chair of our Board of Directors. I started my career at Brown-Forman in 1998 as a marketing manager in the wine division. I was based in California back then and over the years have held a variety of roles in a number of regions around the globe, including positions that took me to Sydney, Amsterdam and London before recently relocating back to our hometown of Louisville, Kentucky.

As Campbell mentioned, in addition to the various operational roles I've had over my 26-plus years with Brown-Forman as well as my nearly 9 years of Board service I've also enjoyed working with members of my family since 2000 when the fifth generation began evolving and formalizing our governance initiatives.

I am very honored to accept this new responsibility as we enter the company's 155th year of operation and I am deeply grateful for the trust placed in me by my fellow Board members and Brown family. I look forward to building on the strong foundation laid by Campbell, Garvin and all those who have previously served as chair of this great company. Please note that the Board and I understand our responsibilities to you, our public partners as you look to Brown-Forman to deliver long-term sustainable growth achieved responsibly over decades and generations.

I have greatly enjoyed meeting some of you at our more recent investor events, and look forward to meeting those I have not met at future investor meetings and events. With that, I would like to turn the call over to Lawson to take us through the first half of fiscal 2025 results.

Lawson Whiting

Thank you, Campbell and Marshall, and good morning, everyone. I hope that Campbell and Marshall's remarks, are a reminder that Brown-Forman believes deeply in building our business to pass on to the next generation. This belief has been ingrained in our culture since 1870 by the sixth generation's of Brown family members who have upheld the legacy of our founder, George Garvin Brown. I've enjoyed working closely with Campbell in his role as Board Chair, his deep understanding of our business and gifts for building trust and confidence in those around them have made a lasting mark on Brown-Forman and our Board of Directors. While I've worked closely with Marshall as a member of the executive leadership team, I'm excited about the opportunity to work with him in his new capacity as Board Chair. In Marshall, we welcome a visionary thinker with excellent strategic acumen. Please join me in congratulating both of them on this transition.

Also, before I share our second quarter and first half results for fiscal '25, I want to express my appreciation to each of our 5,700 employees for their contributions to these results.

They've remained dedicated to our brands and our business through the challenging operating environment. And in doing so, remind me why we often say that there's nothing better in the market than Brown-Forman.

Now to our results. As a reminder, we expected fiscal 2025 to be a year of 2 halves. We anticipated that the second half of our fiscal year would be stronger than our first half as in the first half, we compared against strong shipments related to the replenishment of inventory in a few emerging international markets and buy-ins ahead of planned price increases. This year has largely unfolded as we anticipated. The top and bottom line results that we are sharing with you today continue to be in line with our expectations, and we're again reaffirming our full year organic net sales and organic operating income outlook for fiscal 2025.

I'll start with the performance of our brands, and then Leanne will share more about our geographic performance, other financial highlights as well as our fiscal 2025 outlook. Let's turn to the drivers that influenced our first half 2025 results. Our reported net sales decreased 5% in the first half, while organic net sales were flat after adjusting for the divestitures of Finlandia and Sonoma-Cutrer in the prior fiscal year, the negative effect of foreign exchange and the recent business model change for Jack Daniel's Country Cocktails.

In the first half, an increase in used barrel sales was the most significant growth contribution to organic net sales. From a brand perspective, Woodford Reserve, Diplomatico Rum and Old Forester were the largest growth contributors to organic net sales. These gains were largely offset by volume declines for El Jimador and Herradura.

Woodford Reserve continues to grow faster than the U.S. whiskey category in the U.S. and gained value share within the most recent Nielsen and NABCA takeaway results.

The brand grew organic net sales 8%, driven by increased volume as well as positive price/mix. Results were driven by the growth of Woodford Reserve Distiller Select, the #1 super premium American whiskey globally, along with strong double-digit growth of our ultra-premium offering, Woodford Reserve Double Oaked.

Diplomatico, the #2 super premium plus rum globally delivered very strong organic net sales growth led by France and Czechia, along with the travel retail channel, Germany and the United States. As I mentioned, when we acquired Diplomatico in fiscal 2023, the brand has a strong European presence, aligning well with our investment in owned distribution in markets such as France and Germany, which are Diplomatico's top 2 markets. We've placed Diplomatico into our emerging brands portfolio in both Europe and the United States, its third largest market to ensure it has the focus and dedicated resources to drive its growth. Old Forester, which has consistently provided strong growth despite a volatile environment, delivered double-digit organic net sales growth as the brand benefited from growth of the single barrel expressions and recent releases such as King Ranch Edition, which is exclusively sold in Texas.

While we're very pleased with the performance of Woodford Reserve, Diplomatico and Old Forester, our tequila brands, El Jimador and Herradura continued to face challenges in their two largest markets of the U.S. and Mexico. In the U.S., there have been an increasing number of competitors entering the tequila category, while Mexico's economy has faced a challenging macro environment. Despite this performance, we continue to believe we have the right brands to capitalize on the growth in the tequila category globally over the long term.

Tequila Herradura is a 154-year-old brand of superior quality and taste, and we're highlighting its craftsmanship, heritage and authenticity. This year, we've been celebrating Herradura's heritage as the world's first Reposado across consumer communications as well as hosting — ***indiscernible*** — events across the U.S.

And in Mexico, we've recently launched Herradura Crystal, a Reposado Cristalino that builds upon the region's Cristalino trend. For El Jimador, now that we've repositioned the brand's price solidly into the premium price segment, we have opportunities to grow reach and distribution in the U.S. and we're also optimistic about El Jimador's ability to create and grow in the premium tequila category in the rest of the world.

We saw very strong double-digit organic net sales growth in Southeast Asia as well as Brazil and Australia, where El Jimador is the #1 100% Agave tequila according to IWSR 2023. While this growth was not enough to offset the softness in the U.S. and Mexico, we believe El Jimador has a strong future and can be a key introduction to tequila for global consumers as they begin to understand the mixability and versatility of 100% Agave tequila.

After several quarters of short-term headwinds, I'm very pleased to say that organic net sales for Jack Daniel's Tennessee Whiskey accelerated significantly as we move through the first half of fiscal '25 with sales now flat for the year-to-date period. We continue to invest behind the brand to engage a new generation of legal drinking age consumers while retaining our core consumers. These include the McLaren Formula One sponsorship, music sponsorships, most recently with Shaboozey new media campaigns and the Jack Daniel's and Coca-Cola ready-to-drink product.

RTDs continue to be a bright spot within total distilled spirits, showing growth across most markets with Jack & Coke notably increasing its value share in many markets around the world. We continue to add new markets, including a launch in India in September and new formats and flavors within the United States. The Jack & Coke Cherry limited time offering performed well with initial shopper data from a national grocer showing that Jack & Coke Cherry added incremental shoppers to the Jack & Coke RTD family.

We're also excited to introduce a variety pack featuring Jack & Coke, Jack & Coke Cherry and Jack & Coke Vanilla in the U.S. The variety pack should be widely available in March 2025 as we lean into summer moments such as Time at the Beach, the Lake and music festivals. We believe our continued geographic expansion and innovation opportunities will generate interest and attention for Jack Daniel's RTDs as well as the full strength family of brands.

Before turning the call over to Leanne, I wanted to share our latest thoughts on tariffs as I know it is a topic of great interest. As you know, Brown-Forman has been headquartered in the United States for nearly 155 years, and we're proud to be the leading exporter of U.S. spirits products to the world. The growth and expansion of our global portfolio allows us to grow at home, increasing jobs and investment in the U.S. and everywhere we operate.

Our industry is unique in that many types of spirits like bourbon, tennessee whiskey, Irish whiskey, scotch and tequila are recognized as distinctive products and must be made in their respective countries. So any time these spirits products are targeted by tariffs, there is the potential to create an uneven playing field. At Brown-Forman, we've had an unlevel playing field before given the retaliatory tariffs on American whiskey and as such, have learned from our prior experience. We've been proactively preparing for a variety of scenarios and have implemented mitigation strategies for our portfolio of brands around the world. At this point, there are many unknowns and potential scenarios. It is very difficult to predict how this will play out.

In summary, the first half of fiscal 2025 has unfolded largely in line with our expectations, and we continue to believe that we are positioned to achieve our full year guidance. We're still operating in a highly dynamic environment with many uncertainties. Even so, with all we know today, we continue to expect our second half to be stronger than the first. While our short-term organic results in the first half were below our historical trends, I continue to believe in our long-term growth potential led by our strategy, our portfolio, our geographic breadth and of course, our talented people.

With that, I'll turn the call over to Leanne, and she'll provide more details on our first half results.

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. As Lawson mentioned, I will provide additional details on our geographic performance, other financial highlights and our fiscal 2025 outlook. From a geographic perspective, as expected, we saw sequential organic net sales improvement in each of our geographic clusters as we move through the first half.

Our emerging international markets returned to growth and collectively delivered 6% organic net sales growth in the first half. This growth was fueled by the very strong double-digit growth of Jack Daniel's Tennessee Whiskey, Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Apple in Türkiye and Brazil. Our business in Turkiye benefited from the continued growth of the premium whiskey category. In Brazil, the economy has remained resilient as our results were driven by the growth of the premium plus whiskey category, where we are gaining share, our geographic expansion strategy and the launch of an additional package size for Jack Daniel's Tennessee Whiskey.

Brazil has consistently grown 9-liter depletions for the full strength Jack Daniel's family of brands at a double-digit rate over the past 4 years and has joined the U.S., the U.K. and Germany as a 1 million case market, where the trailing 12-month depletions exceeded 1 million 9-liter cases.

In Mexico, organic net sales of El Jimador and Herradura declined as the challenging economic environment is impacting discretionary spending and consumers are trading down.

Despite the decelerating conditions in Mexico, we continue to outperform and gained market share across the channels, driven by strong takeaway in RTDs and whiskey. In addition, Herradura is driving innovation in tequilas with the launch of Herradura Crystal in Mexico, which builds upon the region's Cristalino trend and addresses the consumers' need for a versatile tequila across occasions.

Organic net sales in the travel retail channel declined 3% in the first half. Growth of Jack Daniel's Tennessee Whiskey and Diplomatico were more than offset by the decline of our super premium American whiskeys as Woodford Reserve compared against very strong double-digit growth and the launch of our exclusive global travel retail offering, Jack Daniel's American Single Malt in the year ago period. We are continuing to innovate in this channel with the timing phased to the second half of the fiscal year. For our developed international markets, organic net sales collectively was down 3% for the first half as growth in Japan was more than offset by declines in the United Kingdom and South Korea.

As we shared last quarter, Japan continued to provide growth following our route-to-consumer change to own distribution on April 1, 2024. While the U.K. returned to growth in the later months of the first half, the market continued to compare against higher volumes in the year ago period related to purchases ahead of the excise tax increase in August 2023.

In South Korea, the premium whiskey category is still experiencing growth, though Jack Daniel's Tennessee Whiskey experienced increased competitive activity while also lapping the prior year launch of Jack Daniel's Tennessee Apple. And in the United States, organic net sales decreased 3%. Double-digit growth from Woodford Reserve, Old Forester and the Jack Daniel's RTDs led by Jack & Coke were more than offset by declines in Jack Daniel's Tennessee Whiskey and Korbel California Champagne.

Lawson highlighted the growth drivers of Woodford Reserve, Old Forester and the Jack Daniel's RTDs in the U.S. Therefore, I'll move to additional comments on Jack Daniel's Tennessee Whiskey and Korbel as well as on inventory and the consumer environment. As a reminder, in the year ago period, Jack Daniel's Tennessee Whiskey experienced a shift in ordering patterns as inventory was purchased ahead of price increases. While the brand declined in the first half of this fiscal year, the brand's 3-month organic net sales trend is ahead of the fiscal year-to-date trend ended October 2024. There's also improvement in the 3-month rolling takeaway trends.

For Korbel, the declines in the first half were largely timing related as we are focusing our promotional efforts on the seasonally stronger second half.

Turning to distributor inventory levels in the U.S. At the end of our first quarter, we shared that distributors were continuing to target the low end of their normal range, which is where they remain. As the important selling month of October, November and December approach, distributors began preparing for the important holiday selling season, and we noted increased shipments for key brands such as Jack Daniel's Tennessee Whiskey and Woodford Reserve. This was done in a few key markets to ensure supply would meet consumer demand and to mitigate the risk of an out-of-stock situation at the retail level as some retailers are continuing to target the low end of their inventory range.

From a takeaway perspective, 3-month rolling value trends for total distilled spirits are down approximately 1% and have remained steady in the first half. The premiumization trend continues with higher-priced tiers growing in value and gaining share. The growth in the $40 and above price tiers are driven largely by the U.S. whiskey and tequila categories.

Moving on to the rest of the P&L. In the first half of fiscal 2025, our reported and organic gross profit decreased 8% and 4%, respectively. This resulted in 240 basis points of gross margin contraction, which improved sequentially as we progress through the first half.

We continue to benefit from favorable price/mix and the Jack Daniel's Country Cocktail business model change. These were more than offset by higher costs, largely driven by the timing of input cost fluctuations, coupled with high inventory levels, foreign exchange as well as the impact of the transition services agreements related to the divestitures of Finlandia and Sonoma-Cutrer that we shared during our first quarter earnings call.

As a reminder, these agreements had a negative impact on our overall reported gross margin as the gross margin for these services agreements were significantly below the sales of finished goods. I will note that as of October 31, 2024, the transition services agreement related to Sonoma-Cutrer has concluded.

As expected, operating expenses in the first half of fiscal 2025 were lower compared to the year ago period, largely due to seasonality of both fiscal years. Organic advertising expense decreased 4% as we compared against the phasing of our brand-building investments in the year ago period.

As a reminder, our spend was significantly skewed to the first half of our fiscal year 2024 for Jack Daniel's Tennessee Whiskey, particularly the superpremium expressions and to support the launch of the Jack Daniel's and Coca-Cola RTD in the United States. Organic SG&A investment decreased 3% for the first half, driven by lower compensation and benefit expenses as we lapped a 9% increase in the year ago period.

In total, reported and organic operating income decreased 7% and 3%, respectively, in the first half of fiscal 2025. These results led to a 3% diluted earnings per share decrease to $0.96 per share. Before moving on to our outlook, I would like to share two additional updates since our last quarter related to Sonoma-Cutrer and our capital allocation philosophy.

In the second quarter, we recorded income of $2 million related to our equity share of the

Duckhorn Portfolio's earnings as a line item below the operating income line on our P&L based on the equity method 1 quarter in arrears. On October 6, 2024, it was announced that the Duckhorn Portfolio would be acquired by private equity funds. Under the terms of the agreement, upon completion of the proposed merger, Brown-Forman will receive cash of $350 million in exchange for our 21.4% ownership interest in Duckhorn. The completion of the merger, which is expected to occur in the second half of our fiscal year is subject to customary closing conditions, including approval by Duckhorn stockholders.

We will continue to report our equity share of the Duckhorn Portfolio's earnings 1 quarter in arrears until the merger is complete. Once our investment is sold, we will recognize the equity method earnings only up to the date of Duckhorn's most recently available financial statements and recognize again on the disposal when the investment is sold, not on a lag.

Secondly, Brown-Forman believes deeply in and remains committed to building an enduring business. As a testament to this belief, our long-term perspective and our enduring commitment to our valued shareholders, our Board of Directors recently approved a 4% increase in the quarterly cash dividend, marking 41 consecutive years of dividend increases. Brown-Forman continues to be a proud member of the prestigious S&P 500 Dividend Aristocrats Index and has paid regular quarterly cash dividends for 81 consecutive years.

And lastly, turning to our fiscal 2025 outlook. We continue to anticipate a return to growth for organic net sales and organic operating income in fiscal 2025, driven by gains in international markets and the benefit of normalizing inventory trends on a year-over-year basis. This outlook is tempered by the global macroeconomic and geopolitical conditions that are creating volatility and uncertainty in the operating environment. We are not forecasting significant changes in the behavior of the consumer or the level of trade inventory as the impact from inflation and higher interest rates on the consumer and trade still remain.

As our first half results aligned with our expectations, we continue to believe that fiscal 2025 will be a year of 2 halves. We have moved beyond the comparison against strong shipments in a few emerging international markets as well as lapping stronger shipments associated with the execution of our pricing strategy on a year-over-year basis.

In the second half, with the majority of the movements in inventories across the distributor, retailer and consumer supply chain behind us, we believe our results will more closely reflect consumer demand. This expectation, though, is dependent on the behavior of the supply chain, which is not within our control. Also, we will begin to compare against a significant slowdown in total distilled spirits trends as well as trade inventory reductions.

And finally, we believe that we will benefit from having a full year of growth from Gin Mare and Diplomatico, which had very strong results in the first half of fiscal 2025. With our pricing strategy in place, we remain confident in the strength of our brands and the breadth of our growth across numerous geographies. Therefore, we continue to expect organic net sales growth in the 2% to 4% range, driven by our emerging and developed international markets.

We also continue to believe that we will benefit from price/mix through the evolution of our portfolio, which includes the addition of the two super premium brands, Gin Mare and Diplomatico and the divestiture of lower-margin brands, Finlandia and Sonoma-Cutrer. Price/mix should also continue to benefit from our revenue growth management activities.

In addition, the transition services agreement for Sonoma-Cutrer has ended, and we expect the transition services agreement for Finlandia to come to an end in our second half, which will reduce the A&D headwind. And while costs were higher in the first half of fiscal 2025 compared to the year ago period, this is largely due to the timing of input cost fluctuations, particularly for our tequila brands. For these brands, we still expect to benefit from lower Agave prices for the full year. Though based on their current performance, it will take longer than expected to work through our higher cost inventory. We have shared that the benefit from the lower Agave prices would be more than offset by the impact of inflation on our input costs and lower production volumes.

With the benefit now being lower, we are forecasting that cost will be higher than planned for fiscal 2025, leading to a slight contraction in our reported gross margin on a year-over-year basis.

Our outlook for organic operating expenses continue to reflect investment behind our brands and our people, though we will continue to be highly diligent with our SG&A spend to balance the impact of these shorter-term pressures on our gross margin. Based on the above, we continue to forecast organic operating income growth in the 2% to 4% range. The low and high end of our organic net sales and organic operating income ranges are based on numerous scenarios with the greatest influence from weaker or stronger consumer demand in key markets such as the United States and changes in distributor inventory levels.

We are operating in a volatile and quickly evolving environment, and our third quarter is seasonally significant to our full year results. We will continue to closely monitor performance indicators and provide you with those updates in our third quarter call. We continue to expect our effective tax rate to be in the range of approximately 21% to 23%, guiding closer to the lower end of the range, and we are updating our estimated capital expenditures outlook from a range of $195 million to $205 million to a range of $180 million to $190 million for the full year as the phasing of a few of our projects will now extend into the next fiscal year.

In summary, the first half of our fiscal 2025 delivered against our expectations. The first half results reflect the current consumer demand environment, along with a few remaining unusual comparisons against the very strong shipments in the year ago period. While our short-term organic results in the first half were below our historical trends and our full year outlook, we believe we will continue to see sequential improvement and growth in the second half.

As we look ahead to our full fiscal year, we remain confident in our ability to deliver our near-term goals as we continue to focus on executing our long-term strategy and building Brown-Forman for generations to come.

I would like to add my thanks to and deep appreciation for my Brown-Forman colleagues around the world for their resilience and agility as they continue to identify opportunities for our outstanding portfolio brands with a dedicated focus on the long-term growth of the company. This concludes our prepared remarks. Please open the line for questions.

Question and Answer

Operator

— Operator Instructions —

Our first question or comment comes from the line of Lauren Lieberman from Barclays.

Lauren Lieberman

I was just curious if you could talk a little bit more about inventory levels. I know Leanne, you touched on it in your prepared remarks. But I think, as always, a key topic of conversation among investors before your call. So if you could just give us an update maybe on absolute inventory levels, particularly in the U.S., I think that you had commented last quarter that they were generally holding steady on an absolute basis. So I was curious if that was still the case? And then how you would sort of characterize distributor and retailer attitude towards the category overall and expectations for growth around the holiday season?

Leanne Cunningham

Okay. Great. Thanks, Lauren. Just to reiterate what we said, we continue to believe that the distributors are targeting the low end of their normal range and that retailers have adjusted their inventory levels in response to that lower consumer takeaway trend and the interest rate environment, similar to what we would have said in the first quarter.

As you can see on our Schedule B in our first half, our shipments this quarter are tend to be slightly ahead of our depletions, and that's reflecting our normal supply chain now from the supplier to the distributor to the retailer to the consumer. But as we prepare for the important holiday selling season, we have increased some shipments for specific brands such as Jack Daniel's Tennessee Whiskey, Woodford Reserve and Korbel to ensure that we've got product there to meet the consumer demand and protect against any out of stocks.

And in the U.S., we're just continuing to work really closely with our partners, and we're not forecasting any significant changes in trade inventory levels. And then I think around the world, it continues to be really similar to where we were at the end of Q1 as well, which is in Europe, where we own the majority of our distribution, our stock levels are normal. We have clear insight into our two largest markets in Latin America, which are Mexico and Brazil. And in Mexico specifically, our RTDs are kind of below normal. I would say whiskeys are kind of in line with the long-term trends and tequilas are a bit above that. And again, that's more about how tequilas are performing in the Mexico market. And Brazil, overall, they're at the low end of there.

So we continue to believe our inventories are well positioned with our distributors. But I would say in the U.S., we are being specific on some brands to support the holiday season and to ensure that we've got cases there to meet the consumer demand. And then I'm sorry, what was the second part of your question?

Lauren Lieberman

Holidays environment.

Leanne Cunningham

The holiday environment, Lawson do you want to speak… talked about that a little bit.

Lawson Whiting

Look, we don't have a lot of data yet on the holidays. So we're obviously going to have to see. I think if you step back and look at total still experience, now I'm going to talk about the U.S. here for a second, and then we can go to the rest of the world. But look, let's even back up a little more than that. Go back 18 months ago. I know many of you know this story, but I think it's important to reiterate what we think has been driving a lot of the trends over the last 18 months.

So we had said, Lauren, it was actually in Boston with you at your conference one was 15, 16 months ago, the U.S. market was still running in that 5% or 6% range. So an elevated number, which was true for the first half of '23 and then '22 even in '21. So we've been dealing with that elevated level for quite some time. And between that time, between sort of Labor Day and Christmas of last year, the market truly fell off a cliff and caught everyone by surprise. And we've been making the argument now for, I don't know – ever since then, really that it was driven by economics and inflation and a consumer who's been pinched. And I think that's proven itself out across a whole lot of different consumer categories really over the last year. And to be honest, it's not really getting a lot better. So we are relatively muted in our expectations for Christmas this year.

If you look at TDS in the U.S., as I said, it went from the 6% range in the summer of ’23 to about 0 at Christmas, and it’s been running negative all year. If you want to find – if you’re looking for green shoots or something positive on a consumer takeaway perspective, the NABCA data is getting better. And that consumer takeaway data, particularly for Jack Daniel’s Tennessee Whiskey, I would say that is one of the more positive things we’re looking at right now is over the last 6 months, those numbers have improved. They’re not improving in Nielsen, and they’re still pretty kind of ugly, sort of down low single digits for sure.

So we still will make and continue to make the argument that it is driven by a consumer pinched and that will eventually work itself out. But I would say we’re relatively cautious on what this Christmas is going to look like.

Operator

Our next question or comment comes from the line of Bonnie Herzog from Goldman Sachs.

Bonnie Herzog

I was actually hoping for a little bit more color on the divergence in trends between U.S. consumer takeaways and your reported whiskey depletions. I guess I’m trying to reconcile the negative, I don’t know, 3% to 4% sales trends we’ve been seeing in the scanner data for the last few months versus your reported flat depletion growth in the quarter. Maybe you could touch on where you’re seeing some strength? Is it non-tracked channels, possibly on-premise? And then love to hear your growth expectation for American whiskey category this fiscal year. And does your guidance assume that Jack Daniel’s will take share?

Lawson Whiting

All right. So for the U.S., I mean, you’re right, there’s been a divergence between NABCA and Nielsen. But I would argue right now that we're sort of running in the U.S. around minus 3%, which is – and that is about what we have reported on an organic basis, and it's about what we're seeing on a consumer takeaway basis. So I don't think the disconnect is all that big. What you have seen is a change between Q1 and Q2. It has certainly improved on an organic basis. But at the end of the day, we're still down sort of, I'll call it, low single digits.

So as far as on and off, they're not too far apart. I think on is about a point weaker. So I think we would say the U.S. market is running about a minus 2% in the off, minus 3% in the overall on. So not too far apart, but not too much different than it was 6 months ago. So that's why we were saying we're not really expecting a dramatic swing, say, over Christmas.

Leanne Cunningham

And then, Bonnie, to the second part of your question about what's built into the guidance. For us, it's about a full year benefit from having Gin Mare and Diplomatico in our results, the continued growth of Japan and then Jack Daniel's Tennessee Whiskey largely outside of the United States.

Operator

Our next question or comment comes from the line of Nadine Sarwat from Bernstein.

Nadine Sarwat

Two for me. While we're on the U.S. first question, can you just elaborate maybe on the performance in October exiting the quarter? Any commentary in November in particular? It sounds like it's more sustained from your comments, but if we could just confirm that.

And then second question, you touched on tariffs in your prepared remarks. Obviously, top of mind, whether that's from imports from Mexico for your tequila business, exports to Europe. Can you talk a little bit more about how Brown-Forman is thinking about these potential risks and levers at your disposal should they come into play? You called out proactively preparing and implementing mitigation strategies. Could you elaborate on that?

Leanne Cunningham

Thank you, Nadine. I'll start with the U.S. to your question. We did see sequential improvement from Q1 to Q2. Q1 in the U.S., we were at a negative 4%. And at the end of our first half, we are at a negative 3%. So we are seeing sequential improvement in this market, along with several of our other markets. We would say for the U.S., one detail I would share is our market share where we were holding in the first quarter, we're slightly declining market share now, and that's largely based on our tequila performance. And I'll turn it over to Lawson for the tariffs.

Lawson Whiting

For our favorite conversation on tariffs. So yes, I know you said it, Nadine, but let me make sure everybody is clear. We've got one tariff conversation around the retaliatory tariffs from Europe based on steel and aluminum, which is what we suffered through in 2018 through 2021. And just as sort of a reminder, that was really all about exports of American whiskey. And as clearly the market leader in that, it was a very painful and challenging time for us. That is scheduled to come back at the end of March. So it's still a few months out, and there's a whole lot that can happen over that time. The range is big. So it could further be suspended, which we think there's a decent chance for that. They can be removed altogether or the most drastic scenario would be coming back at 50%. And I'm sure there's other scenarios in the middle that we could come up with.

We're working with all the government stakeholders that you would imagine we would be and we're obviously advocating for a solution that brings stability to all these trade relationships. But now having said that, we have learned from our prior experience with tariffs. We have been proactively preparing for a number of these scenarios and implementing risk mitigation strategies for our portfolio really around the world. But at this point, there are so many unknowns and potential scenarios, and it really – it is just difficult to figure out how it's all going to play out.

Now more recently, the conversation clearly in the media and basically everywhere has been more about Canada and Mexico and the plans for a 25% tariff there. So now that – now we're obviously talking imports. Welcome to the party, the rest of our industry. We have been suffering alone essentially for all these years on the threat of tariffs. And now it's gotten much, much broader, and we're talking about lots of different categories within alcohol. But our business, the spirits business, given categories like tequila, like scotch, like Irish whiskey and bourbon and Tennessee Whiskey, they're called distinctive products. They must be made in their designated country or even state.

And look, we're a proud U.S.-headquartered company. We're hoping that the administration is going to realize that any growth in sales or production on those distinctive products made outside of the U.S. helps us to grow and brings more investment and capital here. And so we'll see how this all plays out, whether or not these are negotiating tactics are real and how big they're going to be. Obviously, American whiskey is much bigger than tequila for us, but neither one is good for us.

So at this point, Nadine, I wish I could – we don't have any insight or information on this. There are so many potential scenarios and unknowns. It's just difficult to see how it's going to play out.

Operator

Our next question or comment comes from the line of Robert Ottenstein from Evercore ISI.

Robert Ottenstein

Let me go in a little bit of a different direction. Can you talk about Jack Daniel's Tennessee Whiskey in the U.S. and the sort of measures that you're taking to, I don't know if renovate the brand is too strong a word, but kind of restore it back to growth, what your brand health indicators are suggesting? And maybe what we should be modeling or what we should be thinking about for that brand in the U.S. going forward in terms of both volume and pricing?

Lawson Whiting

Yes. So I mean that's a key question for us. And believe me, it's something the company is obviously very, very focused on. So a few things. One, realizing pre the last 18 months, so basically the years of COVID and everything that came after that, the brand was very healthy. I mean the growth rates in the U.S. were solid and good. So it's only been in the last sort of 18 months that has gotten much more difficult. It's not really what we would think of as a brand health metric that is a problem.

Having said that, we are working hard to recruit a new LDA to sort of 30 consumer. And some of the things that we're doing, which we briefly mentioned on the call at least, McLaren Racing has become a bigger and bigger part of our mix of spend. And it's not that we do get some decent visibility on the car, on the racing and all that kind of stuff. But even just as important, if not more important, is the amount of activations we're doing around it, and they often include music. So we're bringing music and McLaren together a little bit. We do something called Jack's Garage. And we're bringing in big acts. Shaboozey is one of them, but there's others also that we bring in and put on these concerts essentially around these races. And I think that is – that's not an overnight fix, but it is something special, unique and something we can own a little bit, and there's a lot more going into that.

The Shaboozey's bar song, we've all heard it million times by now. It is every football game, and it is on the radio still all the time. But it does show relevance, I think, for the brand in that space, and that's – there's a lot of college and above sort of folks. I know going to college football games, they play it like 4 times a game. So we're having some success there. He was on the Lions Bears football game on Thanksgiving Day, and I think we're playing that up too.

So there are things like that. We are mixing up media right now, and there's some new things coming out there, and we've got Jack & Coke. And so there's lots of different things that we are trying to do a little bit differently. And we are starting to see some of that in the metrics, the health metrics that we have. So I'm not going to go deep into that, but some of the key metrics like penetration. So that's the number of people that are actually drinking Jack Daniel's or buzz, how often do we see it? How do people recall seeing activity from the brand and then just perceptions. And these are not things that change around overnight, but we closely monitor it and things are starting to move in the right direction.

So look, it's just a huge brand, well known around the world. It is Brown-Forman at its core and figuring out how the entire company, all 5,700 employees or nearly all of them are focused on getting it turned around. As I said on a few minutes ago, we're starting to see some green shoots in the U.S. and the NABCA data, and we think there's some positive news happening outside of the United States, too. So trending in the right direction.

Operator

Our next question or comment comes from the line of Chris Pitcher from Redburn Atlantic.

Chris Pitcher

Could you just dig in a bit more detail into how big a contribution that the return of shipments to Japan was in the period? Because on my calculations, probably used barrel sales plus Japan added about 2 percentage points to growth and I would imagine on quite high drop-through margins. And then just on the used barrel sales, is that a function of price or volume that's helping that drive through because it was much higher than expected?

Leanne Cunningham

Yes. So for used barrel specifically, you can see that in our non-branded and bulk and you can see it on Schedule B and Schedule C. It's really a combination of just supply/demand and it can even be customer mix at the time. It's volatile. It is just really based off supply and demand, and it is up this year from previous years because of the mix of those combination of things.

From Japan, we've said from the very beginning, I think we've never disclosed specifically what we think that one unique piece of growth is. We've called it out the entire year as a source of growth for us in this year. Even as it related to – there was disruption in F '24 as we were preparing for the transition. And now that we have the transition and the brands in our hands, we are being successful in establishing our business, taking price, capturing the margin. So we are happy with the growth that, that market and that team is able to deliver for us this year.

Operator

Our next question or comment comes from the line of Filippo Falorni from Citi.

Filippo Falorni

So I wanted to go back to the distributor inventory comments. If I look at your Schedule D, it seems like it was a pretty significant contributor to organic sales in this quarter. And if I look on a segment basis, it looks – it was mainly in emerging markets. So maybe can you give us some sense of what happened, particularly in emerging markets? And then in terms of – in the context of your guidance of 2% to 4% for the full year, what are your assumptions in terms of distributor inventories in the back half? Should we expect a continued positive trend in the back half, especially as you cycle easier comps? Or how should we think about that particular item?

Leanne Cunningham

Yes. So what you're seeing in the emerging international market is really a prior year where we were refilling the inventory. So for F '25, it is the absence of the refilling of the inventory in the United Arab Emirates, which we've mentioned before. And then to your question on the role it plays in our guidance, what we've talked about is in our second half, the majority of the movements in inventories across the distributor, retailer, consumer supply chain are behind us, and we believe that our trends are going to more closely reflect total distilled spirits. We've been intentional to say that we anticipate the benefit of normalizing inventory trends on a year-over-year basis as we began to compare against the softening of total distilled spirits trends in the year ago and trade inventory reductions in the year to go. Again, similar to what we said in our prepared remarks.

Operator

Our next question or comment comes from the line of Bill Kirk from Roth.

William Kirk

Related to the tariff discussion, what's your ability to pre-ship into countries? And maybe how does that ability vary by countries where you own your own distribution? And how much of that were you able to do last time European retaliatory tariffs were looming?

Lawson Whiting

Look, I'm going to punt a little bit on that one and tell you it's pretty competitively sensitive how we are handling that. And so we're going to be quiet on that particular topic. We are making some decisions and some tough decisions, but it is a very difficult situation no matter what we do. It's still going to be a very painful situation – painful outcome.

Operator

Our next question or comment comes from the line of Peter Grom from UBS.

Peter Grom

So maybe just two quick housekeeping items. So Leanne, I think you mentioned that you maintained the outlook for both the top and bottom line for the year, but you kind of touched on weaker gross margin expectations versus exiting the first quarter. So would it be fair to assume operating profit growth at the lower end of the range? Or is there an offset elsewhere that maybe I'm not thinking through? And then I guess it sounds like we're still early on kind of the holiday season. But I just would be curious, going back over time, if there's one fewer week between Thanksgiving and kind of Christmas, is there any sort of dynamic in terms of demand or drinking occasions that we need to kind of think through on a year-over-year basis?

Leanne Cunningham

Okay. So to your top and bottom line guide question. So our guidance, as we said in our prepared remarks, the low and the high end are based on various scenarios. It's going to – and if there's varying levels of consumer demand that we have modeled across key markets such as the U.S., and we've also modeled various net – estimated net change in distributor inventories. There are scenarios that fall all across the range that we have provided to you. And what we would say is though we'll have – we're currently planning now for a slight contraction in gross margin. We are being very diligent and tightly controlling our SG&A to make sure that we're balancing the short-term pressures on our gross margin. And then from a holiday perspective…

Lawson Whiting

Yes. I have – to be honest, I've not had any conversations with anyone on fewer selling days between Thanksgiving and Christmas. So I don't – we hadn't even debated that internally. So we've certainly not talked about it like it's a problem.

Leanne Cunningham

Yes. And then as we are continuing to look at performance, it is too early yet to get a look into even the month of November because we are just now in the process of closing out that month. We don't have visibility into those results yet. December, of course, then we don't have either, but we do feel like we will have consumer demand across the entire holiday selling season, and it will net out across all of the holidays that fall inside of November through January.

Operator

Thank you. We have one more question. That is from Eric Serotta from Morgan Stanley.

Eric Serotta

Actually, a couple of questions around the supply side. First, earlier this year or late last fiscal year, you did talk about reducing your production to get your finished goods inventories down. Where do you stand today versus your target? And then the next 2 parts of the question are kind of about industry supply. We have noticed an increase in supply for some allocated bourbons. I'm not talking things in the hundreds of dollars at retail, but things in the, call it, high $20s to $40 range. Are you seeing or expecting any impact on your high-end bourbons from the increased industry supply or on Jack?

And lastly, on the supply side, MGPI has certainly been having its challenges with its third-party customers. What, if anything, do you think that kind of portends for industry supply as you look forward?

Leanne Cunningham

Okay. Well, I can start with the Brown-Forman specific question on inventory levels. I would say, on a year-over-year basis, we've made a significant amount of progress in the reduction of our finished goods inventory across our supply chain. Now we know it needs to be a little bit higher just because of we've transitioned more markets into own distribution. But when you take a look at our cash flow from operations, one of the primary drivers is that we have just lower working capital requirements, and that's driven by the progress that we've made through those lower production volumes that we've spoken about.

Lawson Whiting

Yes. And on the overall industry supply, I mean, it's not much different than we said last quarter on this. I think if you backed up 18 months ago and would have asked that same question, I would have said we were short. I mean it was tight, especially on a brand like Woodford that have been growing so very, very fast. One year later with the slowdown that we've had, we have adjusted our production levels, and I'm pretty sure that the big players in the industry have also done the same. And that is the way this industry has worked for 100 years, and you would expect that to slow down.

The impact on the smaller column craft brands, column challenger brands, whatever you might be, I saw that same report. It's a tough time to be developing new brands by independent companies right now. Retailers are taking – they already have. They've taken inventory all out of the system. And of course, they're going to take out the slower turning SKUs first. And so you've seen struggles there. You've seen distributors that are underwater. The distributor world is really difficult right now. And they have to focus on what makes them the most money, and that happens to be the big brands. And so there are a lot of disadvantages and challenges in that world, and I'm sure they are slowing down right now, and they don't really have the balance sheet like a company like a Brown-Forman would have.

So yes, it's a challenging space to be in. I'm not saying it's really an advantage for us at this point. It’s just the way industry conditions are evolving, the big established brands, I think, have a bit of an advantage right now.

Operator

Thank you. Ladies and gentlemen, this concludes the Q&A session for the call. At this time, I would like to turn the conference back over to Ms. Sue Perram, Vice President and Director of Investor Relations for any closing remarks.

Susanne Perram

Thank you. And thank you, Lawson and Leanne, and thank you to everyone for joining us today for Brown-Forman’s Second Quarter and First Half of Fiscal Year 2025 Earnings Call. If you have any additional questions, please contact us.

Today is actually National Repeal Day, recognizing the ratification of the 21st amendment for the United States Constitution and the end of prohibition in the United States in 1933. I hope that you will join us in raising a glass this day as well as responsibly celebrating during the holiday season. Cheers and happy holidays. With that, this concludes our call.

Operator

Ladies and gentlemen, thank you for participating in today’s conference. This concludes the program. You may now disconnect. Everyone, have a wonderful day.

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