Brown-Forman Corporation, Q1 2025, Earnings Call 2024-08-29

Presentation

Operator

Good day, and thank you for standing by. Welcome to the Brown-Forman Corporation First Quarter Fiscal Year 2025 Earnings Conference Call. — ***Operator Instructions*** — Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your first speaker today, Sue Perram, Vice President, Director of Investor Relations. 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 First Quarter 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 first quarter 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, 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 good morning, everyone. It's a pleasure to speak to you today about Brown-Forman's first quarter fiscal 2025 results.

In June, we shared our outlook for fiscal '25, with the expectation that it would be a year of 2 halves. As you'll recall, we anticipated the second half of our fiscal year would be stronger than our first half on a year-over-year basis as in the first half, we are comparing against strong shipments in a few emerging international markets related to the replenishment of inventory and also lapping stronger shipments that occurred prior to planned price increases. The first quarter results we're sharing with you today are in line with our expectations, and we're confident in reaffirming our full year growth outlook for fiscal '25.

As we move into the details of the quarter, I'll provide an overview of the top line from a brand perspective and share a few insights on gross profit and margin. Then I'll turn it over to Leanne, who will share additional insights on our geographic performance as well as other financial highlights.

Our fiscal 2025 reported net sales declined 8%, with organic net sales decreasing 4% after adjusting for the divestitures of Finlandia and Sonoma-Cutrer in the prior fiscal year. the negative effect of foreign exchange and a change in how we manage our Jack Daniel's Country Cocktail business with Pabst Brewing Company.

We haven't talked about Jack Daniel's Country Cocktails for a while, so let me take a few moments to explain that last point. As you may recall, in fiscal '21, we entered into a partnership with the Pabst Brewing Company for the supply, sales and distribution of Jack Daniel's Country Cocktails in the United States. At that time, Brown-Forman continued to produce certain formats of this refreshing ready-to-drink beverage. But during fiscal '24, we transferred production of all Jack Daniel's Country Cocktails products to Pabst Brewing Company, and as a result, our sales related to Brown-Forman produced Jack Daniel's Country Cocktail products are significantly lower compared to the prior year period.

In the quarter, Diplomático Rum, Old Forester and Woodford Reserve, along with Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Apple, were the largest positive contributors to organic net sales. This growth was more than offset by a decline for Jack Daniel's Tennessee Whiskey.

First, to our most recent acquisitions. Diplomático Rum delivered very strong results in the first 3 months of the year, largely related to the timing of ordering patterns in the prior year period, which created an easier comparison. Gin Mare was also impacted by the timing of ordering patterns in the prior year period, but this created a tougher comparison and led to a slight decrease in organic net sales. Naturally, there is a higher level of volatility in the trends as the trend only reflects 3 months of data. Importantly, in the first quarter of fiscal '25, shipments are largely in line with depletions, and we continue to believe that we'll benefit from having a full year of growth from these outstanding super premium brands in our portfolio.

Old Forester, our founding brand, delivered strong double-digit organic net sales growth as the brand benefited from increased volume and our pricing strategy. The brand continues to be incredibly popular with whiskey consumers, as evidenced by the over 100,000 entries that were received on the first day of the Old Forester Birthday Bourbon Sweepstakes, which gives participants a chance to purchase one bottle at $199.99 at the Old Forester distillery in Louisville, Kentucky. The demand is so high for this special release, we were fortunate to be able to increase the number of bottles available, which is probably welcome news to anyone that has been trying to add a bottle of birthday bourbon to their home bar.

For more than 150 years, we have aspired to uphold George Garvin Brown's founding promise that there's nothing better in the market. I want to wish good luck to everyone who entered the sweepstakes, as I think they will announce winners in downtown Louisville today. I'm also pleased to report that organic net sales growth continued for Woodford Reserve, the #1 super-premium American whiskey globally. This performance was driven by higher volume in the United States, even when total distilled spirits trends remained well below historical levels.

Of the top 20 total distilled spirits brands in the United States, only 2 are growing in the past 13-week takeaway results, and Woodford Reserve is one of them. This speaks to the strength of the brand and also the challenges many in our industry are facing in the current environment. Both Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Apple delivered mid-single-digit organic net sales growth, led by Brazil as well as Türkiye, even as Tennessee Apple was lapping its prior year launch in Korea. In Brazil, we continued our strategic geographic expansion efforts, investing more efficiently with bolder and bigger activities and high engagement content for the consumer.

Turning now to Jack Daniel's Tennessee Whiskey. Organic net sales declined 6%, driven by lower volumes led by the United States, the United Arab Emirates and the United Kingdom, partially offset by an increase in volume in Japan following the transition to own distribution and higher prices in Türkiye. As I mentioned in my opening comment, this decline was expected. In the year ago period, the United States and the United Kingdom experienced a shift in ordering patterns as inventory was purchased ahead of a price increase in the U.S. and an excise tax increase in the U.K.

In addition, in the United Arab Emirates, we faced a tough comparison against the strong shipments in the year ago period due to the replenishment of inventory. As you'll recall, with the supply chain disruptions we experienced, the emerging markets were among the last of the markets to be replenished. We continue to believe that Jack Daniel's has a significant runway for long-term growth despite the recent short-term headwinds. We continue to invest behind the brand and have strategies and plans in place to engage a new generation of legal drinking age consumers, while retaining our core consumers, including the Make it Count global campaign, the McLaren Formula 1 sponsorship and the Jack Daniel's and Coca-Cola RTD.

We're also investing more in short-term activations within the on and off-premise channels and events such as music festivals and McLaren races globally. Music has been an important part of the Jack Daniel's relevance in pop culture, and was recently featured in the mega hit, A Bar Song, also known as Tipsy by singer, Shaboozey. The song was released in April and reached #1 on the Billboard Hot 100 in the United States and other countries such as Australia, Canada, Ireland, Norway and Sweden.

Our global sponsorship with McLaren Racing is also on display, with a top 3 finish for McLaren in 12 of the 15 races held in calendar 2024 with the cars, race suits and the team garage featuring increased branding for Jack Daniel's. There are 2 upcoming races in the

United States, one in Austin in October and then Las Vegas in November. We'll be cheering on Team McLaren to Victory. In addition, we're continuing the geographic expansion of the Jack Daniel's family of brands and are well positioned to capture the global growth of American Whiskey as evidenced by our share growth in markets such as the United Kingdom, Australia, Poland, Mexico and Brazil.

Before moving on, I'll provide a brief update on the continued expansion of the Jack Daniel's and Coca-Cola RTD. While growth from the Jack Daniel's and Coca-Cola launch continue to be offset by the planned declines in Jack and Cola, which makes it difficult to evaluate the brand from an external perspective, but we are very pleased as we enter our second year. We continue to add new markets, expanding further throughout Europe as well as launching in South Africa and additional Latin American markets. We plan to launch in India in September, and expect to be in more than 30 markets by the end of calendar '24.

In addition to geographic growth, we're also innovating. In the U.S., the first displays of Jack & Coke Cherry are beginning to appear. Jack & Coke Cherry will be a limited time offering intended to generate interest and intention for the family of Jack Daniel's RTDs as well as the full strength family of brands. We'll also be introducing a variety pack as package formats and flavors are vital to the ready-to-drink category and further address the consumer trends of convenience and flavor. The Jack Daniel's and Coca-Cola RTD has been a great addition to our portfolio, which is, as you know, we have been very strategically reshaping over the past couple of decades to focus on premium and super premium brands.

Before turning the call over to Leanne, I'd also like to provide some additional perspective on our gross profit and margin. In the first quarter of fiscal '25, our reported gross profit decreased 13% and organic decreased 8%, resulting in a gross margin of 59.4%. This gross margin contraction is largely due to timing.

As we have shared previously, following the divestitures of Finlandia and Sonoma-Cutrer, we entered into a transition service agreement with the buyers to ensure a smooth and orderly transition. These agreements had a negative effect on our overall reported gross margin, as the gross margin for these services agreements was significantly lower than the sale of finished goods. This was the main driver of the 140 basis point negative impact from A&D. Overall costs negatively impacted reported gross margin by 440 basis points, largely influenced by inventory levels and the timing of input cost fluctuations.

In the first quarter of fiscal ’25, we continued to reduce our finished goods inventories on a year-over-year basis. The finished goods that supported our first quarter sales were at a higher cost compared to the year ago period due to the timing of input cost fluctuations, particularly for our tequila brands, as we work through the higher cost inventory.

Leanne will share more details regarding our outlook, but I’ll share now that we do anticipate the headwinds in the first half will become tailwinds in the second half of the year. Favorable product mix with price/mix contributed 200 basis points in the first quarter. There was also a positive impact to reported gross margin of 70 basis points from the recent business model change for Jack Daniel’s Country Cocktails. This is an example of how we continually look for efficiencies and opportunities to improve our production and supply chain. These tailwinds though, were more than offset by the headwinds from A&D and the timing of costs.

In summary, the start to our fiscal ’25 was as we expected, and we believe we’re positioned to achieve our full year guidance. We’re still operating in a highly dynamic environment, yet our portfolio remains well positioned. Our geographic reach is broad and our team members are immensely talented and highly dedicated to growing our business. This has enabled us to navigate short-term volatility and uncertainty as we focus on the long-term growth of our business.

With that, I'll turn the call over to Leanne, and she'll provide more details on our first quarter 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 as well as our fiscal 2025 outlook.

From a geographic perspective, organic net sales for our developed international markets collectively declined 6% in the first quarter, as growth in Japan was more than offset by declines in the United Kingdom and Germany. As expected, Japan returned to growth following our route-to-consumer change to own distribution on April 1, 2024. We are now recognizing the benefits of owning our distribution, including the execution of our pricing strategy. We are very pleased with the transition, and I want to thank all of our dedicated team members for their contribution to this success.

For the U.K. and Germany, lower volumes of Jack Daniel's Tennessee Whiskey had the largest impact on performance. In the U.K., the results of this quarter compared against higher volumes in the year ago period related to purchases ahead of the excise tax increase. And in Germany, annual pricing negotiations lasted longer than is typical, but have now been completed as of the end of June.

In the United States, organic net sales decreased 4%, as lower volumes of Jack Daniel's Tennessee Whiskey were partly offset by growth of Woodford Reserve and Old Forester, with both of these brands having takeaway trends that are outperforming the American Whiskey category. As Lawson has already highlighted, the drivers of these brands in his remarks, I will provide a few additional comments on the inventory and consumer environment.

Just a quick reminder, from our June call, distributor inventory levels were largely at normal levels throughout fiscal 2024 with movement to the low end or just below the normal range in our fourth quarter. Consistent with our expectations, distributors are continuing to target the low end of their normal range as higher inflation and interest rates are impacting the consumer and trade. From a takeaway perspective, trends for total distilled spirits as well as Brown-Forman remain below the long-term historical rates of growth. While rates of growth are moderating, the premiumization trend continues to persist, with higher price tiers continuing to grow value and maintain share as value-priced brands are losing share to RTDs.

The growth in the $40 and above price tiers are driven largely by the U.S. whiskey and tequila categories. Collectively, organic net sales for our emerging international markets, which lapped a 32% increase in the year ago period declined by 5%, driven by a decline in Mexico, led by New Mix and our tequila portfolio as the economic environment is decelerating and consumers are trading down. Despite the decelerating conditions, we continue to outperform and gained market share across the channels, driven by strong takeaway in RTDs and whiskey.

We also had lower volumes of Jack Daniel's Tennessee Whiskey in the United Arab Emirates, as we lap the strong shipments from the replenishment of inventory in the year ago period. These declines were partially offset by growth in Türkiye, driven by higher prices as well as Brazil, where Jack Daniel's Tennessee Whiskey, Jack Daniel's Tennessee Apple and Jack Daniel's Tennessee Honey are benefiting from the growth of the premium-plus whiskey category, geographic expansion and the launch of an additional package size for Jack Daniel's Tennessee Whiskey.

And lastly, organic net sales in the Travel Retail channel decreased 8% as the channel compared against the strong growth from our super premium brands, particularly Woodford Reserve and Jack Daniel's Single Barrel in the year ago period. Growth of Diplomático along with our Single Malt Scotches partially offset the decline. Importantly, consumer takeaway remains strong in global Travel Retail accounts.

Lawson has shared the details of our gross profit and margin for the quarter, so I will now turn to our operating expenses and operating income. In the first quarter, organic advertising expenses decreased 1% as we lapped a 14% increase in the year ago period. As a reminder, the increased spend in the first quarter of fiscal 2024 was largely due to the timing of our spend to support the launch of the Jack Daniel's and Coca-Cola RTD, which was skewed to the first few months of the fiscal year. And our organic SG&A investment decreased 5% as we compared against a 12% increase in the year ago period, which reflected higher compensation-related expenses related to organizational changes including our route-to-consumer expansions.

In total, reported and organic operating income decreased 14% and 13%, respectively in the first quarter of fiscal 2025. These results led to a 14% diluted earnings per share decreased to $0.41 per share.

And finally, to our fiscal 2025 outlook, which we are reaffirming. We 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 our belief that the operating environment ahead will remain challenging and volatile with global macroeconomic and geopolitical uncertainties. In this environment, we are not forecasting significant changes in the level of trade inventories, as the impacts from inflation and higher interest rates on the consumer and trade are expected to continue.

We also continue to forecast that fiscal 2025 will be a year of 2 halves. In our first quarter, on a year-over-year basis, we compared against the strong shipments in a few emerging international markets as well as lapping stronger shipments associated with the execution of our pricing strategy. In the second quarter, with the majority of the movements in inventory across the distributor, retailer and consumer supply chain behind us, we believe our results will more closely reflect total distilled spirits trends.

We expect the second half of the year to be stronger, as we anticipate that we will benefit from having a full year of growth from our outstanding new brands of Gin Mare and Diplomático, and we will begin to compare against the softening of total distilled spirits trends in the year ago period. We remain confident in the strength of our portfolio, along with our pricing strategy and the further globalization of our entire portfolio across vast 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 expect reported gross margin expansion in fiscal 2025 with sequential improvement as we believe we will benefit from price/mix through the evolution of our portfolio, which includes the addition of 2 super premium brands, Gin Mare and Diplomático 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, transition services agreements typically last approximately 12 months, so they should come to an end in our second half, which will remove the A&D headwind that Lawson highlighted in his remarks. And while costs were higher in the first quarter 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 as we work through our higher cost inventory. As we previously shared, we continue to expect that the benefit will be more than offset by the impact of inflation on our input costs and lower production volumes.

Our outlook for organic operating expenses reflects continued investment behind our brands and our team to unlock future growth, leading to growth generally in line with our top line growth. Based on the above, we continue to forecast organic operating income growth in the 2% to 4% range. We also expect our effective tax rate to be in the range of approximately 21% to 23%, and that our estimated capital expenditures will be in the range of $195 million to $205 million for the full year, as we continue to fully invest behind our business to meet what we believe will be the future consumer demand for our brands over the long term.

And lastly, as a reminder, in the second quarter of fiscal 2025, we will begin to reflect our equity shares of The Duckhorn Portfolio's earnings or losses as a line item below the operating income line of our P&L based on the equity method one quarter in arrears.

In summary, our fiscal 2025 started off as we expected. The first quarter 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 quarter were below our historical trends, we believe our brands and our business are healthy.

Lawson and I would again like to thank all of our team members for their continued dedication and contributions in navigating the dynamic operating environment that continues to normalize from the historic manner in which we started this decade. As we look ahead to our 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.

This concludes our prepared remarks. Please open the line for questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from the line of Peter Grom of UBS.

Peter Grom

So you both mentioned, and you guys touched on it in the release that 1Q was in line with your expectations. But just in the context of a challenging start to the year, organic sales down 4%, can you maybe just speak to the confidence or visibility you have in achieving the full year target? I totally understand the comparisons get easier and you always anticipated growth being stronger in the second half. But just any thoughts on kind of just the key building blocks maybe from a category perspective or whatnot.

And then just Leanne, you mentioned 2Q growth will be more aligned with category trends, at least in the data that we can see, they still seem pretty challenged. So is the expectation you would still expect organic sales to be down in the second quarter with a return to growth in the second half? Or am I – or should we expect maybe better performance in the second half versus maybe what I just outlined?

Leanne Cunningham

All right. Great. Thanks, Peter. Again, I'll just start with reiterate a few things. This – we do expect this to be the year of 2 halves. We do expect to see sequential improvement through the rest of the fiscal year. Our first quarter results were as expected. The second quarter, as you said, we mentioned we do believe they more closely reflect the total distilled spirits and where they are, that's more from – if you look at the U.S. trends, that's kind of where we are. And for the second half, we're going to benefit from the full year impact of Gin Mare and Diplomático.

Importantly, a few other things, we will begin to compare against the softening of the total distilled spirits in the year ago period, which was significant in our second half last year. Our cost from a cost perspective we will continue to move through higher cost inventory early in the year. That's largely related to our tequila business, as our cost of agave is actually falling faster than we can move through our inventory, but we'll get to that benefit.

And then I think we have to remind ourselves that there's some absence of some unusual onetime items, which for F '24 would have been the negative impact of the transition of Jack & Cola out of our system into the Coca-Cola system in the U.K., lapping the impact of transitioning of Jack Daniel's Country Cocktails production as well as in F '25, it's about the return of our organic growth in Japan with our own distribution and also lapping some other emerging international markets where – such as the UAE, now that they've got their inventories at more normal levels. And in the year-to-go period, as we look at our innovation pipeline, the impact that would have.

I think it's important to note that – and we were in potential about saying we believe our growth will come from international markets. And when we look at how we're thinking about that, all of them are below what we would consider our long-term growth algorithm.

Operator

Our next question comes from the line of Andrea Teixeira of JPMorgan.

Andrea Teixeira

I just want to follow up in terms of like the cadence and how the inventory levels have been flowing through. I guess you mentioned on the press release and now also the fact that some of your wholesalers have been more cautious in keeping inventory levels low. What are you seeing on the trade? And also what are you seeing from an on-premise and off-premise perspective, right? So part of the inventory buildup is also on the pantry.

So can you talk about how you felt the quarter evolved as you get into the fiscal second quarter and the balance of the year, how we should be thinking of those dynamics from a consumer takeaway standpoint?

Leanne Cunningham

Yes, I'll start with the first part of your question, Andrea. And we believe, in general, again, our distributors are continuing to target the low end of their normal range, and that retailers have adjusted their inventory levels in response to the consumer takeaway remaining below its historical ranges and of course, in the high interest rate environment. You can see on our Schedule B for us, our depletions are in line with our shipments. So really now, we've continued to say that it's really about consumer demand as they pull the inventory through from supplier to distributor to retailer.

We'll say in the U.S., we're working – we can – we have been and we continue to work really, really closely with our distributor partners. And as we said, we are not forecasting any significant changes in the level of trade inventories as we expect the impact on the consumer and the trade to continue as it has been. I'll just finish out on inventory. As in Europe, we own the greatest part of our owned distribution. So our stock levels there are normal, and we feel good with where we are also in Latin America.

From a Brown-Forman internal perspective, from – on a year-over-year basis, we have made progress in reducing our finished goods WIP and raw material on a year-over-year basis inventory levels.

Lawson Whiting

Yes, let me add on a little bit because obviously, inventory levels, particularly at the consumer level, have been jumping around and we spent a lot of time last quarter talking about that. And I know a number of you wrote about it. But where we are today, I think, is interesting.

So – and I'm going to talk – this is about the U.S. first, and then we can go down the Europe path if you want to. But – so total distilled spirits in the U.S. Right now, Nielsen and NABCA are both flat essentially. Last – this time last year, Nielsen was at plus 5.7. So it has gone through 5.7, it got to 0. It felt like overnight last fall and contributed to what was the very weak Christmas that the industry and Brown-Forman had last year. But it's still interesting how quickly it fell off.

In our last call, we talked a lot about why, and we went through the big 3 of the cannabis, the GLP-1s in Gen Z and why we feel those are not the key drivers that these are not structural changes, but it really comes down to consumer spending and consumer inventories. And we still believe those are the 2 biggest factors that have impacted what has happened over the last year.

Now as far as Brown-Forman takeaway in the U.S., I do think it's – there's kind of – there's so many unusual things in this quarter. But one of them is Nielsen and NABCA, I said they're flat in the industry. Brown-Forman is essentially flat to down 1 in NABCA, but Nielsen looks much worse, more like down mid-single digits. That – the primary reason for that is the launch of Jack & Coke last year in Q1. So when we launched Jack & Coke in the U.S., it was a huge chain launch, control states, which would have been the NABCA data obviously, was much slower. And so you've got this big push that happened right at the beginning of Q1 with Jack & Coke, and that factor alone is about half the difference, that 5-point difference between Nielsen and NABCA, half of it is just Jack & Coke.

The other half, which is much more positive and interesting is in the NABCA data, which captures on-premise. The other half of that delta is driven by Woodford and Old Forester in the on-premise, which, from honest, I didn't expect to see that, but both Woodford and Old Forester are really having strong runs in the on-premise right now, well above sort of total distilled spirits in the on-premise, which is pretty weak. It's down between

1 and 2. So we are bucking the trend there and with 2 of our strongest brands that are actually moving the needle and making a difference.

Operator

Our next question comes from the line of Eric Serotta of Morgan Stanley.

Eric Serotta

Leanne and Lawson, hoping you can give a little bit more color into the comment Leanne made earlier that you've made some progress year-on-year in reducing your finished goods and raw material inventories. Does that mean that there is further reduction still to come as you look at the second half? And what would – how are you looking at the impact in terms – of that in terms of gross margins?

The second question sort of related to inventories, but longer term would be, Lawson, any update in terms of your thinking about the level of inventories, maturing stocks out there for the industry? The 12-point-something million barrels aging in Kentucky and I'm sure a lot in Tennessee. How are you thinking in terms of how the market absorbs that as it reaches maturity over the next few years?

Leanne Cunningham

Yes. So Eric, I'll start with the first part of your question. So from barrel whiskey, like we always talk about, that's about our future growth expectation of our aged product. So as we look out, we continue to see demand in the future, we should always expect that to grow. But to my comment on finished goods WIP and raw material on a year-over-year basis, with the volatility that was created by the COVID cycle and strong demand and the supply chain constraints, we've been working intentional and we shared that on our last call to reduce our finished good WIP and raw material inventory levels on a year-over-year basis, we have accomplished that. There is one piece that, if you look at from April 30, our year-end, our finished goods is up a bit, and that is all about us proactively preparing for a variety of tariff-related scenarios.

And then to your point on how it related to gross margin, again, we talked about that as we think about our cost for the full year and where we kind of expect it to be, what's happening in the first couple of quarters of the year is more related to timing as we move through some inventory. But that we were specific to say that we would still have, and that would be offset by the impact of inflation on our input costs and our lower production volumes as we are continuing to focus on returning to more normal levels of our working capital. So I hope that is all factored into our gross margin guidance for the year.

Lawson Whiting

Yes. So the question around industry supplies and the Brown-Forman supplies, it's interesting. First of all, back up a year ago, the conversation was all about, do we have enough? So the conversation has gone 180 in the period of a year. So I tend to not sort of overreact to those, because it's so sensitive to demand, and just a little bit of change obviously can make the industry supply go up and down pretty drastically.

So a few things, though. Within – we're talking American Whiskey for the most part here, we feel pretty good about it right now. The big suppliers are the ones who still control the vast majority of the sales of American Whiskey. And while everyone has been building their inventories, they're still building for sales growth rates that seem pretty reasonable, and we think are going to work its way out. And look, there are levers that we can pull when things get long and short, and we've been doing this for 154 years of managing supply, and I think we've gotten pretty good at figuring all that stuff out.

So I just don't consider the whiskey supply to be one of the bigger risks, and we're not seeing it in terms of pricing in the promotional environment, you're not seeing that flow through either in the – well in the United States at all. So as I say, I think we feel pretty good about the supply situation.

Eric Serotta

Great. And then just one more shorter-term follow-up. One of my favorite quotes from last year from you, Lawson, was Christmas stunk, seems a little silly to be asking about the holiday period with Labor Day weekend fast approaching. But the holiday sell-in will certainly be approaching as well. So how are you thinking about – I know there's various comps and inventory movements and things like that. But how are you thinking about and planning for demand for this holiday season?

Lawson Whiting

Well, look, I mean, yes, that is a tough question. The same old, the comps, it seems to be the answer to everything, because the comps are going to be much, much easier this Christmas than they were last year. Last year really was a, I'll say it was a surprise. I mean it's – not just for Brown-Forman. I mean, the industry was surprised at how rapidly everything seem to fall off. So we've already said that the second half of the year is going to be our stronger, and even Q2 should incrementally be stronger than Q1. And so that includes a better Christmas than last year, but I'm really nervous to try to lay out a prediction on how good it's going to be.

Leanne Cunningham

And I think one thing we can build on that is one thing that we know is while we do continue to see a stretched consumer that is seeking to stretch their discretionary income, premiumization trends are continuing. And we feel like our portfolio is incredibly well positioned for that premiumization trend to continue, which I think you can see about the strong performance of Woodford Reserve and Old Forester during the first quarter.

Operator

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

Nadine Sarwat

Lawson, maybe if I ask my first question, putting the lumpiness of the distributor inventories to one side that we've had over many quarters now. And I look at what the implied underlying net sales growth was, I think it's the weakest now that we've seen in probably about 4 years. So well below that medium-term growth algo, I fully appreciate your comment on sort of this being a year of 2 halves. But could you help us understand what you believe are the underlying drivers of that weakness? And how you expect that to develop over the remainder of the fiscal year, again, focusing on that underlying number rather than inventory?

And then second question related to that, what are you assuming in terms of the health of the American consumer in your guidance versus perhaps what are you observing today in terms of the health of that consumer?

Lawson Whiting

Okay. So if we focus on sort of what are the factors in Q1? And as I said, I'll leave inventory out of it. What to the – I don't know, maybe – I don't know if it's stuck out from our comments that we made earlier. But the price increases last year, which hit August 1 of last summer, so there was buy-in in June, July ahead of that. That's not immaterial. And the same thing with the U.K., same timing, but it was tax increases and you have the commensurate buying ahead of that.

So some of this is timing of all this kind of stuff that impacts depletions and things like that. So – but the – if we're focused on the U.S. consumer themself, I mean, look, obviously, the consumer is weaker. If TDS is down there at 0, both in NABCA, Nielsen, that as we said, that's a pretty steep drop off. But I do think that things are going to improve. This business has gone through these cycles where it drops off and then it comes back very, very – pretty quickly. And we're not betting on quickly necessarily in our guidance, but we are saying that we think it will be sequentially better from each quarter from this point out.

Leanne Cunningham

And then some of the things we'll talk about here, Nadine, as we look forward, in the first quarter, we know like France and Germany were impacted by the lengthy price negotiations that we have, that have now closed. We're continuing to – in the short term, we were losing share there. As we look out, we think we'll continue to be more competitive as we have closed those negotiations. In the U.K., we continue to work to gain share versus the year ago period, even while the consumer is seeking value, their brand **— *indiscernible* —**, they are waiting for their brand to go on promotion and they're looking for deals online.

And then again, in other markets like Brazil, we are gaining share. We've got strong double-digit growth. It's with Jack Daniel's Tennessee Whiskey as well as Apple and Honey and Fire through our geographic expansion that we have there, our shift. We are strategically shifting from grocery to cash and carry to be where the consumer is. And we've launched a new pack size that connects with that consumer. And also in Mexico, it's a decelerating market, but we're gaining value share there across whiskeys and our RTDs, even in an environment where we've got weaker consumer confidence.

So we had – I can throw in Australia. We're continuing to gain share with Jack Daniel's Tennessee Whiskey. So in a lot of these markets, we are continuing to see pockets where even with the changing dynamics of the market, we are gaining share in a lot of our international markets. And that's why we make the comment as we look into the year to go where we're looking for that growth from our international markets.

Lawson Whiting

Yes. Let me add on to, Leanne just said about France and Germany, too, because those are 2 very large markets for Brown-Forman. We haven't been in that proverbial penalty box in a while. But it's a sign that we continue to be persistent in our goal of getting low and slow price increases and Europe's always been the challenge, with the big retailers in pricing. But through different revenue growth management techniques and different negotiations, you stick it out, it hurt the quarter. But the nice thing is that stuff should come back in Q2 and beyond. And so that's just one more reason to believe that we can accelerate from this point forward.

Nadine Sarwat

Got it. And just on what you're assuming in terms of the health of the American consumer in your guidance? Are you expecting that to pick up in the second half of the year? Or is your guidance assuming the status quo from here?

Leanne Cunningham

Yes. Overall, we're in – for the U.S. consumer specifically, we are not expecting a significant change in the consumer trends or behavior.

Operator

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

Filippo Falorni

I wanted to ask a few follow-ups on the gross margin. Maybe we had first, can you break down the cost impact of 4.4 points on gross margin from commodities versus — ***indiscernible*** — from an inventory revaluation impact with the kind of higher cost inventory flowing through. And then looking forward, should we expect that inventory impact to continue in Q2 and then the margin expansion to be really weighted to the second half for the full year? Or can we see some improvement already in the second quarter?

Leanne Cunningham

Yes. So specifically on the 440 basis points of cost, again, it's like we said, it's largely timing hitting largely in the first quarter. If you remember last year, our gross margin started higher and we kept trying to guide others down to where we inevitably landed at 60.5%. This year is going to kind of be the inverse, as we have higher cost in this period due to those inventory cost fluctuations, again, related largely to our tequila brands. As we kind of work through that higher cost inventory, we do think that was largely in the first quarter, we'll get some of that in the second quarter as well. So it's really the second half which will see the absence of that impact or will be to the benefit of our lower cost inventory.

Impact from inflation on our input costs and our lower production volumes will, for the full year, still when we're thinking about cost in total, and we're kind of in that low single-digit range, low to low mid-single-digit range for our full year.

Filippo Falorni
Just a quick follow-up on the transition service agreement. Is that – should we continue to expect a headwind in Q2 from these agreements? And then that to go away or to potentially turn into a tailwind in the second half?

Leanne Cunningham
Correct. They are planned to end as we go into our second half. So again, that's part of our tail of 2 halves from a gross margin perspective. We expect those to be absent as we go into the second half.

Operator
Our next question comes from the line of Robert Moskow of TD Cowen.

Robert Moskow
I wanted to ask about just the marketing efforts on Jack Daniel's in general. You talked at your Investor Day about a lot of plans to improve trends, boost the image of the brand.

How do you think it's going? Because you look at the tracking data and it indicates continued declines. Do you feel like these efforts are strong enough to reacquaint the brand or strengthen the brand in a mainstream manner and offset what I think is happening, which is more shifts to premium offerings?

Lawson Whiting

Yes. Well, look, I mean, the Jack Daniel's brand is still one of the largest and strongest brands in the world. And we very much believe that we've gotten creative out there, the McLaren racing partnership that we have and everything we're doing there. I mean getting back – or not back into, but continuing our efforts in pop culture is one of the most important things that we can possibly do. We talked a little bit about Shaboozey. But that type of thing, and I can tell you the brands in lots of, lots of particularly country music these days. But staying relevant in that pop culture and being able to recruit new consumers every year is kind of what we get paid for. I mean that's what we do.

And so while it is challenging, I would cite that, one, if you step back and look beyond anything beyond one year, the Jack Daniel's brand has remained very, very healthy. Over the last 5 years, the Jack trademark has delivered somewhere between 4% and 5% sales growth. And so if we can replicate that 4% or 5% sales growth, say, over the next 5 or 10 years, this company is very locked and loaded for at least those medium- and longer-term algorithms that we've used where, because the rest of the portfolio has so much strength and for the most part, in double-digit growth mode until COVID and all the chaos over the last few years.

So we do think the math overall works, and we're going to continue to continue to grow the Jack Daniel's brand in the way that we've done for many, many, many years. So as part of that, though, we are – last quarter, we talked about the super premium Jack Daniel's extensions. They're actually one of the bigger contributors to our sales growth last year. So we continue to unveil those. They're unique. They're strong. They speak to the whiskey — ***indiscernible*** —, we like to call them, but they do form an umbrella over the entire trademark and help us to continue to grow.

So we really are looking at what – at these trends over the last 12 months to be a bit of the exception to the rule a little bit. And as I said earlier on one of the other questions, I do really want to predict when the month that, that's going to turn, but we feel like you're going to start to see some improvements. And in fact, to be fair, with the U.S. numbers, Jack is off the bottom, and we know it's starting to get a little bit better, slow, but it's getting – but it is improving.

Robert Moskow

Can I ask a follow-up, Lawson? Like you mentioned you kind of nailed it there that the key here is to get younger consumers to engage with the Jack Daniel's brand, bring new consumers to that brand. Like do you – what metrics do you follow to see if like those younger consumers are watching these ads, that the message is resonating with them and that it's starting to change their perception of the brand?

Lawson Whiting

Yes, look, I mean as you would expect, we have a very full set of consumer insights and data that we track literally monthly, I think I can probably say that. So – and we can break that down by age, and we do spend a lot of time debating the recruitment versus retention debate that basically all big brands have. And look, and so this new campaign, we believe, the one that Back in Black is kind of what we call it internally, but having that song is more relevant. Everybody kind of knows it. And so we think we know we're making progress there, and it indeed does show up in our statistics.

Something I forgot about to mention a minute ago, it came through in our prepared remarks, but I find it – if you look at the U.S. and you look at the 20 largest brands in the

U.S., the fact that only 2 of them are growing, to me, is pretty incredible, and we said on the call, Woodford is one of the two.

If you look at the biggest brands in the U.S., they are the ones who look the worst in these Nielsen trends, which speaks to the argument we made last quarter, which is the biggest brands were the ones that everybody was buying during COVID and the post-COVID boom years, those are the ones that are sitting in the consumer's cabinet and have taken them while to move through. So I think it just provides a little more evidence that, that – to some extent, we don't really know the extent. It's a very hard number to pin down, but it contributes to why you're seeing such slowdown in trends on the very biggest brands.

Operator

Our next question comes from the line of Nik Modi of RBC.

Nik Modi

Lawson, I was hoping you can just share your perspective. I mean, feedback from the trade in August would suggest a pretty steep drop off at the industry level. And just curious kind of what you guys are observing just broadly why there could have been such a precipitous drop from July to August?

And then just kind of piggybacking on that. I mean, the more we hear about the delta-9 on cannabis beverages and how fast they're selling out when they're on display. And I know you kind of dismissed it last quarter, but I'm just curious, like have you seen some traction for some of those products and maybe infringing on some of the beverage alcohol occasions?

Lawson Whiting

All right. Well, the first one, July to August, I mean I – to be honest, I don't know. I have not heard that. I've not heard that from our own teams either. So I'm not sure what the source is or I don't know, I really can't comment on it.

But on the cannabis and specifically beverages and cannabis, I mean, I think I've said this in a few different times on these calls. Cannabis has been around for a long time, just because it's going from illegal to legal hasn't – I mean, I know it's gummies and all that kind of stuff are certainly exploding compared to where it was. But I just – I don't believe it has much of anything to do with the current trends. I do not see cannibalization say, between a cannabis beverage and a spirit brand.

So now people have said and studied this stuff, that beer is much more apt to getting if there is some cannibalization between cannabis and beverage alcohol, the beer is the one that's at risk. And I kind of can believe that. I mean it makes logical sense, I think, and spirits, in particular, would be the least affected by that.

So we'll have to see. I just – I still can't picture beverages, cannabis beverages – look, it was just my opinion. So others may differ from it, but I just don't see that being a big business. There's just too many other ways you can – you don't need to sit and sip it. And there's only so much you can sip anyway. It's not like it's – you're going to sit there and drink a 6-pack of the stuff. So I just think it is a business opportunity. I'm in the camp but it's pretty limited.

Leanne Cunningham

And then the only thing I'll add to that from a consumer research perspective, we were – our findings are that spirits are the preferred alcoholic beverage type among the individuals, who use cannabis in the past month. So that's what our consumers are telling us.

Operator

Our next question comes from the line of Steve Powers of Deutsche Bank.

Stephen Robert Powers

So in the quarter, we saw distributor inventories tick up 3 points in the U.S. and 4 points in developed international. And just relative to your comments that you're not really expecting much improvement in the consumption run rate, especially in the U.S., I mean, is there a risk there, that, that kind of one quarter build unwinds as we go into 2Q or the remainder of the year? How are you thinking about that?

Leanne Cunningham

Our comments really is about a year-over-year perspective, and it's about lapping the softening of the total distilled spirits trends that we saw in the year ago period. So when we think about our year to go, and again, we'll have the largest benefit of that lapping in our second half. That was really a year-over-year comment. Because, again, with distributors and our outlook of their inventory levels, it continues to be that we are not forecasting an outlook that has significant change. We're continuing to believe that the trade and consumer behavior will be similar to what it is now.

Stephen Robert Powers

Right. Okay. I just mean consumption is down versus year ago inventory levels that sequentially came down to reflect deteriorating consumption. And now consumption isn't improving and inventory levels are going up. So it just seems like there's some risk built in there, but we can – I can follow up later.

The second question would be, you talked about France and Germany being headwinds in the quarter, but sort of normalizing as we go forward as you've gotten through those retailer negotiations as a benefit to the remainder of the year. You also talked about full year contributions of growth on Gin Mare and Diplomático as kind of being a notable contributors to the – especially the second half improvement in your outlook. Is there a way to quantify the impact of those dynamics as you move from 1Q into 2Q and then 2H?

Leanne Cunningham

I mean I think what we can say that they are all implied in our guidance and what we've said first half, second half. From an organic perspective, again, with the shipment base for Gin Mare and Diplomático compared to where we were last year, we believe we're going to have a benefit in this year. We are not quantifying that specifically or quantifying the benefit that we believe that's in our year-to-go period now that we have concluded our pricing negotiations in Germany and France. But again, we believe that we had the biggest impact from those negotiations, specifically with Germany and France in the first quarter that now will not be present as we go forward.

Stephen Robert Powers

Okay. Okay. And I don't know if I could squeeze in a third here, if you're generous, thank you in advance. But tequila, notably weak this quarter, it was soft last quarter as well. Can you expand on why it was – just before that, we were talking about tripling tequila as we look out into the future. I'm sure that's still the ambition. But just trying to understand why the softness so acutely in these past couple of quarters? And how do I think about that as we go forward?

Lawson Whiting

Yes. Okay. I'll take that. A couple of things. One, before I hit our own. I just – I find these 2 statistics pretty interesting – is an IWSR thing. But they said that in this calendar year in 2024, tequila is going to surpass vodka as the largest value category in the United States, which for anybody that's been in this business for a few years, that to me is pretty incredible as to how rapidly that has grown. The other part of it are contributing to that, I guess, is that 22 to 24 year olds are just as likely to be drinking tequila as they are beer, which that also floors me a little bit that, that has grown that much.

So a lot of our tequila weakness, one is a lot of it's Mexico. We are pushing price very,

very hard down there. Now we're pushing price in the United States, too, and that is a competitive thing we're doing right now. But while the U.S. total distilled spirits pricing is still holding together, it's very, very low single digit. Tequila has actually gone a little bit negative, not massively, but I think it's down 1 point or something like that. So – and now we're up like 3 points. And so we're sort of keeping our head down a little bit and continuing to push the price button whenever a lot of other brands are going the other way.

Now I don't – I mean, look, the category is still one of the strongest categories out there in spirits. And we've – while we've not kept up with some of the famous brands that are out there, [Herradura] in particular, is one of the sort of core, most important brands in our portfolio. We haven't done great. But I can tell you, over the last – not the last 2 quarters, but our growth rates in the last few years have all been kind of double digit or very high single digit.

And so while we're a bit critical these days of the tequila trends right now, you got to remember, they haven't been a drag on the company's growth rate. They've actually been a net positive. So it's a very, very competitive category now. There's a lot of brands in there. We have one of the – we have one of the best, we still believe it, and we're going to continue to push forward.

The other – there's been a fair amount of talk, I guess, about the internationalization of the category. And el Jimador is actually pretty well positioned to be able to go after that. It's one of the biggest brands in a bunch of markets like the U.K., like Australia, like Brazil, some others. So it's kind of – people don't really know that or follow that, but it is a growth opportunity for us.

Operator

This concludes the question-and-answer session. I would now like to turn it back to Sue

Perram for closing remarks.

Susanne Perram

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

We look forward to participating in the Barclays Global Consumer Staples Conference next week, and hope to see many of you. For those of you unable to attend, our fireside chat will be made available as a webcast accessible via the Brown-Forman corporate website under the section titled Investors, Events and Presentations.

We wish everyone an enjoyable weekend, particularly those in the United States that are celebrating the Labor Day holiday. And on Monday, September 2, we hope you will join us in raising a glass as we say happy birthday to our founder, George Garvin Brown, and good luck, again, to those of you who entered into the Birthday Bourbon Sweepstakes.

With that, this concludes our call.

Operator

Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.