Brown-Forman Corporation, Q4 2024, Earnings Call 2024-06-05

Presentation

Operator

Good day, and thank you for standing by. Welcome to Brown-Forman Corporation Fourth Quarter and Fiscal Year 2024 Earnings Results Conference Call. — ***Operator Instructions*** — Please note that today's conference is being recorded.

I will now hand the conference over to your speaker host for today. Sue Perram, Vice President and Director of Investor Relations. Sue, 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 Fourth Quarter and Fiscal Year 2024 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 fourth quarter and fiscal year 2024. 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. Thank you for joining us today as we share Brown-Forman's fiscal 2024 results. Before diving into the details, I wanted to provide a few high-level comments on our performance and my perspectives on the year.

Brown-Forman is a 154-year old company, so we have been through periods of complexity and uncertainty in the past. We understand what it means to be resilient. We know how to navigate short-term challenges while remaining focused on our long-term strategy. Fiscal 2024 has certainly been a challenging year as we're still operating in a highly dynamic environment. While our business is not immune to the impacts of industry and macroeconomic headwinds, Brown-Forman and its people have remained agile, focused and committed to the long-term growth of our brands and of our business.

There's certainly a lot of complexity to our results. which we will walk you through momentarily. However, when you consider our depletion-based results, which we believe represents the true health of our business, we're pleased with our fiscal 2024 performance as it is in line with our long-term growth expectations. While that statement may surprise some of you, this past fiscal year was greatly impacted by changes in consumer, retail and distributor inventories. We believe our brands remain healthy. We're in the right categories and price points and we're confident in the outlook for our business. So let's discuss all of this in greater detail.

Throughout the year, we've been using the word normalization as we lapped the impact of the supply chain challenges and the rebuilding of inventory in the prior year as well as consumers getting back to historical consumption patterns. We expected our organic results to moderate in fiscal 2024 after 2-plus years of double-digit growth. However, as we move through the year, conditions changed, consumers faced higher inflation and increased interest rates that made them as well as distributors and retailers reconsider when and how they made purchases. In this environment, our fiscal 2024 results were below our expectations with organic net sales declining 1% and organic operating income decreasing 2%. And this is where it gets particularly complex and potentially confusing. So thank you for allowing me to get into the weeds here a bit.

As seen in Schedule D, the estimated net change in distributor inventory had a very significant influence on our results this year, reducing our organic net sales by 6% and operating income by 14%. The scale of this impact is significant when compared to any other time prior to the pandemic as the estimated net change in distributor inventory has historically only impacted organic results by 1 or 2 points in any given year. The sizable difference in fiscal 2024 between shipments and depletions was driven by several factors converging at one time. This includes the tough comparison against the rebuilding of distributor inventories in fiscal 2023 related to the glass and supply chain challenges, along with the more recent changes in distributor and retail ordering patterns.

We found that the timing and size of orders has fluctuated from their historical patterns to adjust for higher interest rates and moderating consumer demand. We believe our performance is best captured by factoring in the impact from the estimated net change in distributor inventories, which is what I referred to earlier as our depletion-based results. These depletion-based results, which capture the sale of our brands from distributors to retailers is the way we manage our business internally within Brown-Forman and the way we incentivize our leaders.

From this perspective, our top line results more closely reflect our longer-term trends, and our bottom line results were particularly strong. For these reasons, we believe the fundamental health of our brands and our business remains solid. We've also been using the word normalization because if we look back over the past 5 years, which encompasses the numerous impacts of the pandemic, our 5-year organic net sales compound annual growth rate is 6%. This is in line with our long-term growth algorithm and demonstrates our strong track record of consistent and sustainable results over the long term.

I also want to highlight the 150 basis points of reported gross margin expansion that we delivered in fiscal 2024. We've benefited from favorable price mix as we continue to execute our long-term pricing strategy along with our enhanced revenue growth management capabilities. We also benefited from the growth of our super-premium brands. Price mix, along with the absence of the supply chain disruption costs in the prior year period more than offset higher input costs and unfavorable foreign exchange. We're very pleased with our strong reported gross margin expansion and believe we will continue on this path in the coming fiscal year.

Now as we dig into the full results of the fiscal year, I'll start with our top line performance and share some highlights from our portfolio of brands. Leanne will then provide additional details for fiscal '24 before providing our outlook for fiscal '25.

The main growth drivers of organic net sales for Jack Daniel's Tennessee Apple, the Jack

Daniel's super-premium expressions, New Mix and Glenglassaugh. We haven't talked much about these brands in the past, but they are examples of how the consumer trends of premiumization convenience and flavor continue to drive our business. They also illustrate the value and importance of our portfolio evolution and innovation strategy as well as our continued geographic expansion and route-to-market strategy. The work we have done to build a diversified global portfolio focused on premium and super-premium brands provides us with many opportunities for growth even in dynamic and challenging times.

Jack Daniel's Tennessee Apple was a top performer as the brand delivered very strong double-digit organic net sales growth and is now almost 900,000 9-liter cases. The brand was launched in 2019, just prior to the beginning of the pandemic when the closure of the on-premise and supply chain disruption significantly impacted our ability to build brand awareness. However, the supply and logistic challenges eased we were better able to meet consumer demand for the product. Today, we're seeing strong growth in markets such as Brazil and Chile, and we've also continued to introduce the brand into new markets and had a strong launch in South Korea in fiscal '24.

Collectively, the Jack Daniel's super-premium expressions also delivered strong double-digit organic net sales growth in fiscal '24. This growth was led by Jack Daniel's Sinatra. Jack Daniel's Single Barrel Rye Barrel Proof and the newest member of the bonded series, Jack Daniel's Bonded Rye, our exclusive global Travel Retail offering, Jack Daniel's American Single Malt also contributed to the strong results.

Over the last several years, to meet consumer preferences, we have purposely premiumized the Jack Daniel's family of brands and elevated our whiskey credentials through innovation and specialty launches. This allowed us to offer both long-term friends of Jack Daniel's and new friends, the opportunity to explore and discover within the Jack Daniel's family.

Of course, another trend in beverage alcohol is the continued growth of ready-to-drink beverages specifically spirit-based RTDs. This trend is evident in our fiscal ’24 results, with New Mix serving as the second largest positive contributor to organic net sales growing to more than 10 million 9-liter cases in fiscal ’24. The brand continued to deliver double-digit organic net sales growth, benefiting from higher pricing and value share gains in the RTD category despite a challenging environment in Mexico.

The third largest positive contributor to overall organic net sales was Glenglassaugh, as the brand’s awareness and prestige among whiskey connoisseur continue to grow. Most notably, Glenglassaugh Sandend, being named the 2023 Whiskey of the Year by Whiskey Advocate Magazine. And as we’ve shared over the last couple of quarters, the brand continued to benefit from cask sales, particularly in Asia through its old and rare program. The growth from these brands was almost entirely offset by declines in organic net sales from Jack Daniel’s Tennessee Whiskey.

Jack Daniel’s Tennessee Whiskey declined 5%, led by lower volumes in Japan as we transition to own distribution, the United States due to slowing consumer demand and the United Arab Emirates and Sub-Saharan Africa, both of which had strong comparisons given the significant rebuilding of inventory last year.

As we shared during our Investor Day in March, despite recent short-term headwinds in our industry, we believe Jack Daniel’s has a significant runway for growth and are confident in achieving our long-term ambitions. Jack Daniel’s remains one of the most iconic brands in the world with solid brand health and a long-term performance track record with the Jack Daniel’s family of brands, growing volume at a 5% compound annual growth rate over the past 5-, 10- and 30-year periods.

The fact that the brand's 5-year growth rate is the same as its 30-year growth rate means that it is not slowing down. That is impressive for a brand of its size. The Jack Daniel's family of brands is a robust portfolio that expands across multiple occasions, price points and geographies, and we believe we have strategies and plans in place to engage a new generation of legal drinking age consumers while retaining our core consumers.

In addition, we are positioned to capture the global growth of American whiskey as we accelerate the geographic expansion of the Jack Daniel's family of brands. We continue to support the brand's health and growth through the Make it Count global campaign, the McLaren Formula 1 sponsorship and the Jack Daniel's & Coca-Cola RTD.

I do want to acknowledge that the impact of Jack & Coke RTD is difficult to see in our fiscal '24 results, primarily due to the transition to Jack & Coke RTD from our preexisting Jack & Cola RTD business. Even so, we continue to believe Jack & Coke is an iconic brand and a fabulous product and can build a stronger and more global foundation for the Jack Daniel's family of brands.

Consider, for example, the Jack & Coke RTD grew to 4.5 million 9-liter depletions in over 25 markets around the world in fiscal '24, of which 2 million of the cases were incremental, leading to more than 120 million cans in consumer hands. Brand investment increased significantly in markets where we transitioned from & Cola to & Coke with more than half of the increase contributed by Coca-Cola. And very positive consumers volumes with greater than 86% of consumers indicating strong intent to repurchase Jack & Coke RTD.

Jack & Coke was a significant portfolio enhancement for us as were the additions of Gin Mare and Diplomático. In fiscal '24, Gin Mare and Diplomático were integrated into the Brown-Forman portfolio of brands, and I'm pleased to say that both brands delivered strong double-digit organic net sales growth. These brands have given us scale in Europe and enabled route-to-consumer changes such as our recent announcement for Italy's own distribution transition. And with these brands, Brown-Forman owns at least 1 of the top 5 brands globally in 4 strong growth categories. Super-premium American whiskey, super-premium tequila, ultra-premium gin and ultra-premium rum. We believe this portfolio evolution alongside product innovation, gives us the best opportunity for long-term growth and value creation.

As I close, I want to thank my Brown-Forman colleagues around the world for their commitment to our company values and their daily efforts to deliver our long-term ambitions. Throughout our 154-year history, it has been the strength of our people, the health of our portfolio and the breadth of our geographic reach that has enabled us to navigate short-term uncertainty and volatility. While we experienced a very dynamic operating in fiscal '24, we still believe the spirits category and Brown-Forman offer attractive growth. We delivered over 60% gross margin and 30% operating margin, while generating strong cash flows with high returns on capital, we and are well positioned to benefit over the long term from the evolution of our brand portfolio and the investments behind our brands and people.

Leanne, I'll now turn the call over to you to provide more detail on our fiscal '24 performance and our outlook for fiscal 2025.

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. As Lawson has thoroughly reviewed our top line growth and the performance of our brands for the fiscal year, I will share details on our geographic performance, other business results and our outlook for fiscal 2025.

First, from a geographic perspective, emerging international markets and the Travel Retail channel delivered mid- to high single-digit organic net sales growth, respectively, which was more than offset by organic net sales declines in the United States and the developed international markets. In the United States, organic net sales declined 4%, largely reflecting lower volumes due to a negative 4% impact from an estimated net change in distributor inventory.

First, I'll speak to the significant amount of noise, if you will, created by changes in distributor inventories in the U.S. market for our business this fiscal year. We have been sharing with you throughout this fiscal year. In our first half, we cycled against the significant inventory rebuild during the same period last year. As we entered our second half takeaway trends for total distilled spirits and also for our business moved below the historical mid-single-digit range as consumer demand slowed.

As consumer takeaway remains below its historical range, retailers have adjusted their inventory levels in response to the slower demand and the higher interest rate environment. 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. While we are on this topic, I will add here that in our outlook, the expectation is that distributor inventory levels will remain consistent with their current levels.

Now to turn to what we believe are the more important indicators of the health of our business in this market. While total distilled spirits trends continue to be below their historic norms in the low single-digit range, our portfolio of brands is holding share. Consumer demand for U.S. whiskey particularly super-premium is strong as U.S. whiskey remain one of the largest contributors to total distilled spirits value growth in Nielsen.

In the whiskey category, consumers continue to seek premium-ness, which drove the growth in our super-premium Jack Daniel's offerings, such as Jack Daniel's Single Barrel Rye Barrel Proof, Jack Daniel Sinatra and Jack Daniel's Bonded Rye. All of which delivered strong growth. This growth partially offset the decline in Jack Daniel's Tennessee Whiskey volume. In addition, our founding brand, Old Forester, delivered another year of double-digit organic net sales growth driven by strong consumer demand.

The Woodford reserve was negatively impacted by an estimated net change in distributor inventory levels from a depletion-based and takeaway perspective, the brand remains healthy with strong consumer demand. In our developed international markets, collectively, organic net sales declined 5% in the fiscal year and was negatively impacted by 6% due to an estimated net change in distributor inventories. In Germany, our largest developed international markets, we have been continuously gaining value share, which drove 7% organic net sales growth.

Growth from Glenglassaugh cask sales in Singapore the continued launch of Jack Daniel's Tennessee Apple in South Korea and the integration of Diplomático were more than offset by the decline in Jack Daniel's Tennessee Whiskey largely related to the route-to-consumer transition in Japan. Japan is one of the world's largest spirits markets with a significant footprint and a leading position in premium-plus whiskey and we have now transitioned successfully to own distribution on April 1, 2024, representing the 16th market where we own and operate the distribution of our portfolio. Though there are short-term impacts to our P&L as we increase the ownership of our route-to-market, we believe these investments will lead to unlocking growth for our broader portfolio of brands.

The Travel Retail channel, which has returned to its pre-COVID level of 4% of our organic net sales delivered 6% growth driven by strong double-digit growth from our super-premium brands, particularly our exclusive Global Travel Retail offering, Jack Daniel's American Single Malt along with Woodford Reserve and Glenglassaugh, this growth was partially offset by a decline in Jack Daniel's Tennessee Honey.

And wrapping up our geographic commentary with emerging international markets that collectively increased organic net sales by 8% for the fiscal year despite a 12% headwind from an estimated net change in distributor inventories, which was largely driven by the lumpiness of how the supply chains were refilled in these markets in the second half of the prior year. Jack Daniel's Tennessee Apple drove the organic net sales growth, most notably in Brazil and Chile due to our ability to meet the strong consumer demand with the return of consistent supply.

In Mexico, as Lawson mentioned, New Mix continued to deliver strong double-digit growth as the brand continued to benefit from our pricing strategy and gain share of the RTD category. This growth was partially offset by declines in el Jimador and Herradura, particularly Herradura Ultra, largely due to the challenging macro environment. Jack Daniel's Tennessee Whiskey growth was led by Türkiye, as momentum in the premium whiskey category continue.

Moving to our gross profit growth and gross margin expansion of 150 basis points. For the full fiscal year, reported gross profit increased 1%, with organic growth of 2%, the successful efforts of executing our pricing strategy and reducing cost led to reported gross margin expansion of 150 basis points which was in line with our expectations. In total, our favorable price mix and the absence of supply chain mitigation costs more than offset higher input costs and the negative effects of foreign exchange.

Now to operating expenses. Our total reported operating expenses increased 1%, with organic increasing 7%, which, again, was in line with our expectations. The increase in reported operating expenses was driven by increased SG&A expense, advertising expense growth and the negative effect of foreign exchange. The increase was largely offset by the absence of a noncash impairment charge for the Finlandia brand name in the prior year as well as the absence of post-closing costs and expenses in connection with the acquisitions of Diplomático and Gin Mare in the prior year.

Our advertising expenses, as we have shared with you throughout the year had abnormal seasonality due to the phasing of our investments behind the launch of Jack Daniel's &

Coca-Cola RTD in the first half of the fiscal year, that moderated through the year which reported an organic advertising expense growth of 4% and 2%, respectively, for the fiscal year.

Reported SG&A expenses increased 11% in fiscal 2024, led by higher compensation and benefit-related expenses and our commitment to the Brown-Forman Foundation to support the vision of transformative community impact. Our organic SG&A expenses grew 7%, as we continue to invest behind our people and strategic route to consumer initiatives. Again, we anticipate that these investments, which have short-term impacts on our P&L will unlock future growth.

In total, reported operating income increased 25% and organic operating income declined 2% in fiscal 2024. These results led to a 32% diluted earnings per share increased to $2.14 per share.

And lastly, to our fiscal 2025 outlook, we believe our business is continuing its path back towards our longer-term norms following the significant multiyear disruption related to our supply chain, 2 years of exceptionally high demand and the current impact of higher inflation and interest rates on the consumer and trade. We remain confident in the strength of our portfolio that is well positioned to capitalize on the consumer trend of premiumization that excites existing consumers and convenience and flavor that provides access points to new consumers along with our pricing strategy and the further globalization of our entire portfolio across vast geographies.

We expect that the operating environment ahead will remain volatile with global macroeconomic and geopolitical uncertainties. In this environment, we are not forecasting significant changes in trade inventories as the impacts from inflation and higher interest rates on the behavior of the consumer and trade are expected to continue. We do believe we have now experienced the majority of the movements in inventories across the distributor, retailer and consumer supply chain and that we will benefit from having a full year of growth from our outstanding new brands of Gin Mare and Diplomático. Therefore, we expect organic net sales growth in the 2% to 4% range, driven by our emerging and developed international markets.

Similar to fiscal 2024, we expect fiscal 2025 to be a year of 2 halves. In our first half, on a year-over-year basis, we will still be comparing against the strong shipments in a few emerging international markets as well as lapping stronger shipments associated with the execution of our pricing strategy. We expect the second half of the year to be stronger, which is reflected in our guidance. We believe we will benefit from price mix through the evolution of our portfolio and our revenue growth management activities. And while costs will continue to benefit from lower agave prices, we expect 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 reflect continued investment behind our brands and our people leading to the growth generally in line with our top line growth.

Based on the above, we anticipate 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%. We will 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. Therefore, in fiscal 2025, we estimate our capital expenditures will be in the range of $195 million to $205 million for the full year.

And lastly, as a reminder, in fiscal 2025, we will begin to reflect our equity share 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.

In summary, we believe we have navigated the highly dynamic operating environment in fiscal 2024, maintaining our growing market share in some of our largest markets, including the U.S. And from a depletion-based perspective, our full year results came in, in line with our expectations and consistent with our long-term growth algorithm. It was great to see many of you in person during our Investor Day in March. From there, you may recall that we shared that we believe our business is healthy and the issues impacting our top line growth are temporary and not structural, which we hope we have clearly shared, our largely related changes in inventory levels.

We are confident with the support of our 5,700 employees who are incredibly committed to Brown-Forman and the opportunities we see for our portfolio of brands and our ability to achieve our fiscal 2025 outlook as well as our long-term ambitions.

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

Question and Answer

Operator

— *Operator Instructions* — Our first question coming from the line of Bryan Spillane with Bank of America.

Bryan Spillane

I guess just a couple of quick questions, probably more clarifications. But I guess the first one, can you give me – you mentioned ingredient costs as inflationary for next year. Is that like corn? I know we have obsessed so much about agave and barrels, but I just wanted to kind of clarify – just what it is that's moving against you.

Leanne Cunningham

Yes. So Bryan, it's Leanne. And the things that we have going, again, as a tailwind for us will be the agave, which we've talked about many times. It's kind of going from that MXN 28 to MXN 30 per kilo at the high. We've now seen down to as low as MXN 9 per kilo in

June, depending on the quality of it.

And also grain, we're continuing to expect lower prices in the shorter term, but still above the pre-pandemic averages. Where we're seeing some increases are related to our glass, even though we have lower natural gas and diesel prices that are slowing the rate of inflation, we're still expecting that in the U.S., where the vast majority of our glass comes from, it will be 2% to 3% increase.

And then, again, with transportation, that's going to be in the low single digits. So what will also be – what we talked about in our prepared remarks, higher inflation on our cost, but then also the cost associated to lower production volumes. That's all about us working to return to our more normal levels of working capital on our balance sheet.

Wood, we've talked about a lot over time, the commodity cost continues to be high. We've made – we've talked about adjustments in our infrastructure that we believe will help to offset some of that commodity costs, but we still expect it to be high as well.

Bryan Spillane

All right. Leanne. And then, Lawson, maybe can you just give us a perspective as you're looking forward, I guess, this year, the category has been soft. Is your expectation in term – and I'm really more focused on American Whiskey. Is the expectation that the current trends kind of hold for next year? Do you expect that the category to accelerate? And just to tie to that, Lawson, can you talk a little bit about the amount of inventory – the industry inventory kind of sitting, I guess, aging at this point and whether we're at risk of, like an oversupply situation. We've had that question a couple of times, so it would be great to sort of get your perspective on it.

Lawson Whiting

Yes. All right. Bryan. A few things. One, U.S. whiskey and tequila, which are our two biggest categories continue to be the healthiest part of TDS. So that is a good thing. But TDS has been bouncing along in that sort of 1% range now for what, 9 months, something like that. So it hasn't really changed a whole lot. So it's obviously been a tough year for the consumer and a tough year for us.

One thing I think that's important to hit. Leanne said it a bit in her opening remarks, and I think it's the sort of question of the day, is the changes, is the slowdown structural in some way or another, where spirits demand, which COVID aside, was been in that 4% to 5% range for decades and decades or is it largely based on timing, really difficult comps and the inventory issues. And I do believe the big three that everyone talks about, GLP-1s, cannabis and Gen Z, they are headwinds that are looming in the long term, but I don't think that really has much if anything, to do with the current state of the consumer or the current state of the spirits business in the U.S.

And the reason I say that is, when you look at TDS, and say, in Nielsen, I mean it was going along actually pretty well. And then late summer, early fall, it fell sharply, and it caught everyone in our industry, including you all. I think everyone got caught up in it, and was surprised a bit by it. But I really do believe that it's really driven by inflation for the most part and then there was a level of demand that got pulled forward during COVID and that's the consumer element of it that we talked about last quarter, a lot on this conference call, where consumers had an extra bottle or 2 sitting in their cabinet at home and it's taken some time to work through that. And so I'm just not a believer that things like cannabis have a lot to do with the current state out there.

If TDS went from 5 to 4.5 to 4, and you saw this sort of gradual weakening I would be honestly more worried than I am now based on every trend that we can follow.

And then your other question about industry whiskey supply, I've seen a few people write things about that in the last few months. So it's something we track internally and have been for a long, long time as part of our planning processes. And a lot of it has to do with what you think the demand is going to be going forward, obviously.

So for a long, long time, whiskey wasn't growing in the United States. It has for the, what, last 12 or 13 years, but we went through that 40-year window or it didn't grow at all. And so supply and demand were kind of equal. I think it depends on what you think the forward-looking demand number is going to be, but it doesn't seem to be that far out of line for us. We actually kind of have a different point of view on that than some of the folks that have written that.

I do think it's important to note, too, the majority of the inventory that is out there is from the larger suppliers. There's a lot that's been written about the number of craft producers that have multiplied many times over the last decade. I don't really – that's not really what I – that's not what I'm even worried about, but that's not where I think the oversupply, if there is much is coming from. It's the big players. I mean it's in whiskey, it's – you know who they are. I mean it's the big players that have been continued to build for a long-term growth, and they're behaving rationally for the most part. And I think – so I just don't see there being that big disconnect between supply and demand.

Operator

And our next question coming from the line in Nadine Sarwat with Bernstein.

Nadine Sarwat

One short term and one long term for me. On the short term, coming back to inventories, obviously, large headwind in this quarter. Could you talk about how this compares versus your expectations on the last conference call? And what would have been the cause for any difference there? And a little bit more color on where your inventories are today? I understand the sort of the moving parts, but you feel they're fully at the right level, rightsized to that right level going forward?

And then my long-term question coming back to the U.S., what's your best assessment of where underlying spirits net sales growth for the U.S. today is for the industry? Obviously, Nielsen and NABCA covering some very different channels. And what would you need to see in your opinion, for the industry to get back to mid-single digits? Is it a more favorable macro environment for the consumer? Is it something else?

Leanne Cunningham

Nadine, I'll take the inventory question. Again, kind of pointing to what we have talked about that our depletion-based results came in, in line with our expectations.

First, I'll point you to Schedule B for fiscal 2024 depletions are ahead of shipments on our full strength portfolio and even to a greater extent than when they – than when we reported in our third quarter call. In the U.S., we know retailers have adjusted their inventory level in response to the consumer takeaway trends being below the historic mid-single-digit range and with a higher inflation rate environment.

We've been talking about for the entire fiscal year, is that at the distributor level, our distributor inventories have been within that normal targeted range as we have gone through the majority of this fiscal year. However, in the fourth quarter, in the U.S., the distributor levels did unexpectedly for us to drop to the low end or just below their normal targeted range.

We're continuing to partner really closely with them as we have been all year, probably even more so now. But I will say we do believe we've now experienced the majority of the movement in the inventories across the distributor, retailer and consumer supply chain. And our kind of thoughts on that in our prepared remarks, we have that built into the guidance that we've provided.

And then I'll turn it over to Lawson for the second part of your question.

Lawson Whiting

Yes. So the question is just being a little bit over the longer term, when and what's it going to take essentially to get the U.S. market back on track again. It's very difficult to predict what is going to happen with consumer spending. I mean the one thing we know for sure is the comps are going to get easier. So even not only ours but even in the Nielsen number world that, as I mentioned earlier, that sort of August, September fall off, we're coming up upon that. And so I hate talking about easier comps, but the reality is that they will ease up.

I do believe, given partially the way you call it underlying or depletion-based results are better than shipments. This largely is an inventory correction issue that includes the consumer, as we said just a minute ago, the consumer has got to work through its – the bottles that are sitting at home. And we talked about this on the last call, and I know a few of you all did some analysis on this and sort of agreed, I think, with our statements that it was going to take about a year to work through that consumer inventory. And so we're coming up on that year lapping period in a few months.

So it's difficult to predict and consumer spending is going to need to improve across all CPGs, not even just spirits. I mean, the consumer has been hurt everywhere. So – but if you pin me down and said, what do you really think? I think we would say that sometime in the fall or into the winter that trends will improve.

Leanne Cunningham

And then the only thing I'll add is, and we've said it in our prepared remarks, again, but just to emphasize it, in the U.S. and some of our other key markets, we have been able to maintain market share in this volatile environment. So we feel good about with all the noise that's in the system that our brands are maintaining the share in the marketplace.

Operator

And our next question coming from the line of Robert Moskow with TD Cowen.

Seamus Cassidy

This is Seamus Cassidy on for Rob Moskow. So given the target that you reiterated at your March Investor Day to double fiscal ’22 operating income by fiscal ’32. With fiscal ’25 expected to be another below algo year, I’m curious how you see this trending beyond fiscal ’25 and maybe what you expect to get operating leverage in the out years? Given that you’ll need to invest more this year in terms of advertising and promotion.

Lawson Whiting

Yes. Well, look, we always knew that ambition was not easy, call it, lofty a little bit, particularly the last couple of years or really last year for the most part, has been difficult. But look, 2032 is still a fair ways away. We still believe in the portfolio and everything that we are doing has the growth characteristics to deliver on those goals. And so our long – we’re not changing our long-term growth algorithm at all.

And you asked about leverage. I know we are working very hard to get some gross margin leverage around here. And so I think that’s going to take continued work. But continued – you’ve heard me say before, low and slow, I want to continue that. And everyone is – we’re all on board and focused on that right now. And thankfully, even in the current environment that we’re in today, we still think that pricing is a lever and all this to continue to generate growth, and it’s actually coming through in the numbers. And so a little bit of gross margin improvement with expense controls that make sure that our operating expenses don’t grow at a rate greater than our sales. I mean, that’s the model that we believe in and will continue to do. And I know we’re only 2 years into this 10-year plan. And so there’s plenty of time to accelerate.

Seamus Cassidy

That’s helpful. And then maybe just one quick follow-up. You’ve sort of talked about your excitement about a return to annual pricing in the spirits industry. But you also sort of called out inflation as something that's been a headwind for consumers. So I'm curious how you're thinking about that in fiscal '25?

Lawson Whiting

Well, look, I mean, we've kind of already hit that. I mean the consumer demand is normalizing. We all – not we all. But I mean, keep in mind, with this 2.5 years' worth of double-digit growth, where every – it was difficult to drop all that to the bottom line because it's all the things you all know about. But it was outstanding for a period of time. And I think it's just a return to that normalization a little bit.

I think if we're honest with ourselves, a year ago, we thought that meant it was just the market was going to hit go back to that 4% to 5% range and stay there. And it's taken a year of being below that to sort of correct this consumer inventory thing. So the timing, we'll see, but I still feel pretty confident that the long-term outlook for spirits in this country is excellent and nothing really has structurally changed. So did that answer the question?

Seamus Cassidy

Yes.

Operator

And our next question coming from the line of Lauren Lieberman with Barclays.

Lauren Lieberman

Great. I guess, completely hounding on what you guys have already been talking about. But the notion that the inventory clean up both the distributors, consumers, retailers and so on is complete. It's just very different than what we're hearing from others in the industry. So not taking issue at all with your view, Lawson on the long-term health of the industry that nothing structural has changed. Really just getting at the question of the longevity of the correction and the visibility that there is. So I was just curious, what is it that you guys are seeing or your reasons to believe that, that inventory correction throughout the distributor, retailer consumer landscape is complete?

Leanne Cunningham

And this goes back, Lauren, to what we've been saying for quite some time now with all the disruption that has been in our system that started with the pandemic and the glass supply challenges, logistics challenges, we continue to be in a significantly different position than most of our comp set because of the glass supply challenges that we have gotten into.

We've talked about this over time, how we prioritize brands, we prioritize markets to rebuild and refill our supply chain. And even in '24, there was lumpiness that we had to compare against, especially in the fourth quarter when we were in the prior year where we were reloading our emerging international markets. And we have had to comp against that. We've come up to in – we've come up to normal inventory levels where others were in a different place and may be coming down. And so we really felt like we have been there and been closely aligned with our partners in the U.S. distribution system.

For us, it really was about that unexpected drop in their inventory levels in the fourth quarter as they got kind of down to absolutely the lowest end and just below their targeted inventory range. So that was kind of for us the [mess] and what was unexpected as we continue to do our work. We continue to believe the vast majority of that movement is now behind us, but we're definitely not saying that all of it is behind us as it relates to the U.S. So again, all of that would be included in our guidance.

Lawson Whiting

And understanding the distributor side of it and the retailer is fairly clean, and we have data against it. The biggest question is the health of the consumer itself and when that comes back. And look, everybody is going to have a different opinion on that and I don't have a great crystal ball any better than you do. We're just – I won't walk through the consumer example again, but we do think that the pantries are not as full as they were a year ago. And it just depends a little bit when the consumer comes back and start spending in a big way, particularly also, we haven't talked at all about the on-premise, but on-premise has weakened over the last year, and that doesn't help overall trends either, but we think that will start to come back too over the next year.

Leanne Cunningham

And again, it was just one small line in our prepared remarks, but the importance of what we talked about that in our outlook, it just assumes that where our inventories are today, it's going to continue going into the future.

Lauren Lieberman

Okay. And Leanne, actually, I wanted to clarify on that point. Should we think about that as the absolute level of inventories – distributor inventories or where they should be. So from a growth standpoint, like the next quarter or 2, there's still a headwind to growth. But again, like at an absolute level, we're at the right point. If you're following what I'm asking.

Leanne Cunningham

Yes. So what we're talking about is kind of they're – in the U.S., they're kind of at the low end or just below their levels. In our guidance, it assumes they're going to stay consistent with where they are right now. And that – as we move forward, we've talked about in our outlook, we're going to go against our first half strong shipments. Again, part of it is related to the lumpiness of the shipments in the prior – in F '24, for the emerging international markets, but then also in the U.S. against – as we executed our pricing strategy last year that would have seen our shipments in the first half. And again, all that's built in. So the stronger first half as we look at F ’25 and – sorry, and then we expect a stronger first – second half in ’25.

Lauren Lieberman

Okay. Okay. Got it. Absolute levels, but then the growth rates are something different, but the absolute levels have kind of reached the point where they need to be.

Leanne Cunningham

Generally…

Operator

Our next question coming from the line of Nik Modi with RBC.

Nik Modi

Lawson, I had two questions. First was just on Jack Daniel’s, given all the kind of line extension over the years and different flavor expressions, have you, as an organization, figured out how to spend behind the Jack Daniel’s equity and really kind of provide a halo for all the expressions because there’s a lot of innovation coming out from other players in some of these areas. That seems like there’s some cannibalization of your business. So I just wanted to get your perspective on how you think about brand building long term.

And then just kind of sticking on the Jack Daniel’s mainline brand. We’re hearing a lot of promotional activity from your competitor base. Some of that’s not tracked in the Nielsen or Circana data, redeemable coupons, et cetera. So just wanted to get your perspective on that and kind of how you’re thinking about that embedded in your guidance?

Lawson Whiting

All right. So first – hit the Jack one first. Well, for one, in the short term, and then I’ll take it a little bit longer term and a little bit higher up. But organic net sales for Jack Daniel’s Tennessee Whiskey, so Black Label was down 5%, but there was an 8% impact from the net change in distributor inventories. And so let's not think that all of a sudden, the brand is in this big decline from a consumer perspective. We still feel very good about that. There's just – there's been so much noise. And we're also comparing against in the prior year – prior period, some very high numbers.

And so when you step back and you look at it, say, on a 5-year basis or even longer than that, the brand has maintained the growth rate. I think we just said that same growth rate on a 5-year basis, 10-year basis on a 30-year basis, it's all plus 5%. So we're not seeing a long-term slowdown even in Tennessee Whiskey as we have introduced – we've had the flavors. It's been a few years since we've introduced a new one, but we've brought all these higher end line extensions that we've been doing on the brand that I do think act – I mean they drive profit in and of themselves, but they're also a halo over top of the brand or the franchise all together.

Look, the health metrics remain stable. And we just – we do believe that Tennessee Whiskey is going to normalize over the next year. And so it's – and then back to the marketing and the brand expense and the levels that we have and all those kind of things. Look, we've changed up the marketing mix quite a bit over the last few years. We do – I'm very happy with the state of the brand and some of the communications that we're doing now. We're doing a whole lot with McLaren Racing, and that's been fun, and it's been interesting and a different brand building model for the brand, but a very good one, a very, very premium one.

And as far as absolute spend to be able to continue to deliver the kind of growth and momentum, we're pretty comfortable with where we are and expect I think we've said many times before, the brand expense is going to grow in something close to the brand's top line sales.

So the combination of Black Label continuing and remaining in growth mode. We will continue to do some innovations. RTDs are very popular right now and Jack & Coke while just getting started is something we really believe in. And we do have a pipeline of new thoughts on premium offerings. And so we remain comfortable overall with that.

And then back now down to the second question that you asked on the U.S. pricing environment and maybe you and I maybe were looking at the same thing. I'm actually – I've been a little surprised that some of our competitors have said that because I'm looking at the data, and I'll just throw out some very basic ones. But TDS pricing, a 52-week basis is 1.2 on a 13-week basis is 0.8. So still positive, and it's positive across most of the our brands, particularly American whiskey, which I don't know if I'm surprised at this necessarily, but American whiskey pricing is as strong as any – probably the strongest pricing environment of any of the major categories in the U.S., which bodes well that rational people are maintaining a positive price outlook. And we are definitely as part of that. We're in that – just even Woodford, for example, plus 1.9 and Jack is plus 1.3. So that low and slow thing comes back again, particularly in American whiskey.

Tequila is a little different. And we'll see how this plays out over the next year or 2 or 3 years. A lot of you have written stuff about agave cost and what's that going to do the promotional environment. But it's not really happening yet. It's not coming through in the numbers, and you mentioned it, I think with a coupon thing or so. I actually don't really know about that. But I can say that the big tequila brands, particularly ours and some of the stronger tequila brands, continue even over a 13-week basis, take pretty hefty price increases or they're not discounting.

There are already a couple of brands that are having a struggle and they're weaker and they are starting to discount a little bit more. They're not ours and we hope that the industry will maintain sort of that rational pricing perspective, but you just don't see it through the numbers now. So I'm not sure why everyone is coming up with this the notion that the environment has gotten a lot more promotionally driven.

Leanne Cunningham

And the one thing I'll add to that is for el Jimador specifically, when you look at Brown-Forman's pricing in tequila versus TDS, you will see ours is definitely higher. And that's all about the repositioning of our el Jimador brand getting it firmly into that $20 to $29.99 price tier where we see the fastest growth right now. So – and we have a new package that will be coming out that supports that in this year. So we're excited about what we'll see from el Jimador as we move forward with that price repositioning work we're doing.

Operator

Our next question coming from the line of Filippo Falorni with Citi.

Filippo Falorni

I had a question on the developed international and emerging market business. In the past calls, you talked about some weakness in some European markets. So maybe can you give an update there and also in emerging on Mexico.

And then for the second half of the year, Leanne, you mentioned the improvement in the second half. What gives you the confidence in the improvement in the second half on top line? Is it mainly the kind of the comps on the inventory side? Or are you assuming also an acceleration in category growth in the U.S. and international markets?

Leanne Cunningham

I'll start with your last one first because it's the most succinct which is about what we will be comping in the second half of this year. And then to go to some of the international markets. In the U.K., we're continuing to hold our value share in both the on and off trade. The consumer does continue to reduce their spending and trade downs present in that market.

For us, Germany continues, and you can see that in the numbers continues to be really strong and the consumer climate there, we see as improving. Poland, we're still growing nicely in that market while consumers are remaining cautious with their spending. And then France, it's just a market, I think it's a consistent theme we've talked about for the entire year, which is they just continued to down trade and having the promotional activities. So maybe having the Olympics this summer will change that a bit.

And then as it relates to Mexico, the similar trend is what we have been reporting, which is the consumer continues to be slowing down in spending, and we've been talking about that in our business, and you can see that through el Jimador and Herradura performance.

Brazil, we continue to deliver low single-digit growth there because our Jack Daniel's Tennessee Apple is just being really well received with the consumers, and it's driving market share gains and the consumer takeaway there is slowing a bit as well, and it's the competitive environment intensified that we're were actually delivering double-digit or strong growth in Brazil.

Lawson Whiting

Let me add one point on the U.K. Just because if you look at Schedule C, it looks kind of ugly on the U.K. down 14% sales, but they're very importantly, that is largely driven by Jack & Coke and Jack & Cola. So that was a very big Jack & Cola market a very healthy and a good business for us for a long time. That is the cleanest example, I guess, of a market where we used to sell directly ourselves, and now it's the Coca-Cola Company is doing it. And so we've had to pull Jack & Cola off the shelves and now we're selling like we do with all the other markets for Coca-Cola sign was – effectively selling them concentrate really, which just obviously has a lot lower sales number. So it makes the U.K. look worse than it really is.

Filippo Falorni

Great. That's helpful. And then maybe following up on the gross margin question previously. Is the Q4 decline in performance mainly driven by the lower inventories that you had expected? Have you already starting to see some of those cost inflation headwind that you mentioned for next year already playing out in Q4? And then thinking about '25, I know you mentioned there's puts and takes, agave favorable, some other commodities inflationary. But overall, are you still expecting some margin expansion – gross margin expansion in '24 – '25?

Leanne Cunningham

So to your first one, the big change in the fourth quarter is really going to be driven by inventory-related costs as we would call it LIFO. And it's our LIFO calculation on the year-over-year change of what we had in the fourth quarter of '23 compared to the fourth quarter of '24. So that's the extreme change there.

And then related to gross margin expansion for F '25, just – as we talk about reported gross margin, the change in our portfolio as it relates to the addition of Gin Mare and Diplomático and the divestiture of Finlandia and Sonoma-Cutrer that will provide us with gross margin expansion from a reported perspective. And then for the rest of our gross margin, we will have that low single-digit favorable price mix, largely driven by price in F '25. But again, that's going to be a little bit more than offset by cost and our – the work that we will be doing to normalize the working capital on our balance sheet.

Operator

And our next question coming from the line of Peter Grom with UBS.

Peter Grom

So Leanne, maybe building on that last question, you kind of touched on this, a tale of 2 halves, first half more subdued. Can you maybe provide some parameters in terms of how you're thinking about the first half versus second half in terms of growth rates?

And then maybe kind of following up to Filippo's question, it seems like one of the primary reasons you're expecting a more challenged first half was due to the tougher shipments. But can you maybe just share what's embedded in the guidance from a category perspective? I think you mentioned that the improvement in the back half is more comp driven, but there just doesn't seem to be a lot of visibility in terms of when this inflection to the historical growth rate occurs. So just would be curious what's kind of the assumption embedded into the outlook from a category standpoint?

Leanne Cunningham

Well, I would say from what we are looking for in our growth rates, is we shared that it was really going to be driven by developed and emerging international markets that those will be driving the greatest growth rates to your point, the tale of 2 halves that we will have in F '25, which will be – because of disruptions we've had the tale of 2 halves story now for a couple of years. Again, for us in the first half of '25, it's really going to be about comping against those strong shipments that we had in the first half.

Conversely, when we just talked about the lower distributor inventory levels, we'll be comping against that in the second half of this year. As we – when we continue to look at our business, we continue to be on a path back to kind of our long-term growth algorithm. In F '25, it will be another step in that path back to normalization. But again – with what we see right now from the consumer, the trade, we're just assuming that we're pretty consistent with where we are until we get some indicators of change as we go through this year.

Operator

And ladies and gentlemen, that's all the time we have for our Q&A session. I'll now turn the call back over to Sue for any closing comments.

Susanne Perram

Thank you, and thank you to Lawson and Leanne and to everyone for joining us today for Brown-Forman's Fourth Quarter and Fiscal Year 2024 Earnings Call. If you have any additional questions, please contact us. As we close, I want to acknowledge an anniversary that the company just celebrated yesterday on June 4, 1924 in the midst of Prohibition, Brown-Forman relocated to its headquarters in the location that we're sitting in today. Marking a Century is another milestone in our 154-year history and a reminder of the agility and resilience of this company and its people as we work every day to ensure that there is nothing better in the market.

With that, this concludes today's call.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.