Brown-Forman Corporation, Q2 2022, Earnings Call 2021-12-08

Presentation

Operator

Good day, and thank you for standing by. Welcome to the Brown-Forman Corporation's Second Quarter and First Half Fiscal 2022 Earnings Conference Call. . Please be advised that today's conference is being recorded. I would like to hand the conference over to your speaker today, Sue Perram, Director of Investor Relations. Please go.

Susanne J. Perram

Thank you, and good morning, everyone. I would like to thank each of you for joining us today for Brown-Forman's Second Quarter and First Half Fiscal 2022 Earnings Call. Joining me today are Lawson Whiting, President and Chief Executive Officer; and Leanne Cunningham, Senior 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 the company undertakes no obligation to update any of these statements, whether due to new information, future events or otherwise.

This morning, we issued a press release containing our results for the second quarter and first half of fiscal 2022, 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 E. Whiting

Thank you, Sue, and good morning, everyone. I'm pleased to share our second quarter and first half of fiscal '22 results with you today. But before I do, we'll open up with a toast, a toast to the fact that after 3.5 years, the U.S. and EU reached an agreement on trade in steel and aluminum and the EU will be removing tariffs on American whiskey on January 1, 2022.

The tariffs have been in place longer than I've been in this role. And as such, it's been one of the most discussed topics of my tenure as CEO, having been a part of our conversations in the past 12 quarterly earnings calls as well as the last 3 annual stockholder meetings. It's been an exhausting and expensive chapter in the company's 151-year history, as we've been so disproportionately impacted by the tariffs compared to our competitors. We've remained strong and resilient as an organization, and I believe we are very well positioned to deliver solid growth in the short and the medium and in the long term. That said though, you can be certain that we look forward to the return of a level playing field for American whiskey in the EU and hope a similar outcome can very soon be achieved between the U.S. and the U.K.

So with that, let's turn our attention to the other headlines of our first half. First, our top line growth remains strong, driven by the reopening of the on-premise channel, the return of tourism and the cycling of the lower comparisons during the first half of last year, most notably in the emerging markets and travel retail. Second, we really do have pretty significant optimism about the health of the spirits industry and our business in particular. We continue to see strong consumer demand across our portfolio of brands, and we're benefiting from consumers increased preference for spirits and the sustained growth for both the American whiskey and tequila categories.

Our portfolio, which consists largely of premium and super premium brands is also benefiting from the continued premiumization trends across our industry. Our other major headline is that we continue to face challenges from the supply chain, largely related to glass supply, which has really impacted our finished goods inventories, along with the inventories of both the distributor and retailer levels. This is a contributing factor to the difference in our reported and underlying results. While we're working to mitigate this impact, the supply chain challenges along with higher input costs, mainly related to agave continue to pressure our gross margin. Leanne is going to talk more about this in just a few minutes.

I'll start with the top line, where our overall underlying net sales increased 12% in the first half even as supply chain disruptions had an adverse effect on the year-to-date results. This was led by a double-digit underlying net sales increase for the Jack Daniel's family of brands. Within the Jack family, Jack Daniel's Tennessee Whiskey fueled the growth with underlying net sales of plus 15%. The first half of this fiscal year is benefiting from relatively easy comparisons as the prior year included a time period where the on-premise channel was largely closed around the world.

On a 2-year CAGR, Jack Daniel's Tennessee Whiskey grew underlying net sales 3%, which is similar to the low single-digit growth the brand delivered pre-pandemic. The consumer trends of flavor and convenience continue to drive the growth of the Jack Daniel's flavors and Jack

Daniel's RTDs. Higher volumes of Jack Daniel's Tennessee Honey just celebrated its 10th year in the market as well as the continued international launch of Jack Daniel's Tennessee Apple contributed to high single-digit growth in underlying net sales for the Jack Daniel's flavors. Jack Daniel's RTDs grew underlying net sales mid-single digits in the first half of the fiscal year. Notably, this growth comes against difficult comparisons. On a 2-year CAGR the Jack Daniel's our TDs delivered 19% underlying net sales growth.

So overall, we believe consumer demand for RTDs remains very strong on a global basis, Woodford Reserve continued to benefit from premiumization trends, which were only amplified by the pandemic and the growth in the American whiskey category. The brand again delivered double-digit underlying net sales growth despite supply chain challenges. We believe the underlying consumer momentum for Woodford Reserve remains incredibly strong.

Our full strength of tequilas Herradura and el Jimador continue to benefit from the strength of the tequila category and grew underlying net sales in the first half by 46% and 19% respectively. This increase more than offset a decline in new mix, which, as a reminder, experienced exceptional growth in the first quarter of fiscal '21, driven by the temporary interruption in Mexico's beer supply chain.

In addition, our emerging brands portfolio in the U.S. continued its momentum, growing strong double digits even as it was cycling the strong double-digit comparison in the first half of last year. Old Forester, Chambord, our single malt scotch portfolio and Fords Gin led this growth. We also strengthened our investment behind our emerging brands teams in several markets in Europe this past year.

Based on our experience in the U.S., we know that super premium brands benefit from a high level of focus and we're seeing the benefit in Europe already as the Woodford Reserve family of brands, the single malt scotches as well as our tequilas and Chambord have responded with very strong growth. I do think our portfolio of super premium brands, supported by a dedicated emerging brands team offers the company a really big opportunity for growth internationally, and we plan to be more aggressive in our expansion plans in the future.

The key themes in the first half of this fiscal year are really about our focused efforts on driving top line momentum but while absorbing the cost of the tariffs and significant increases in input costs, especially agave and wood, and through it all, we continue to invest in the long-term health of our brands. But thankfully, I do believe many of the headwinds we have faced are beginning to become tailwinds. The emphasis on long-term growth and performance is built into Brown-Forman's DNA.

We're fortunate to have a shareholder base that understands the importance of making decisions today that will deliver value for the next generation. This long-term perspective is replicated time and time again in all that we do, and is foundational to our business strategy as well as our integrated environmental, social and governance commitments.

We recently updated our global sustainability goals, which serve as a road map for advancing our sustainability efforts, reducing the company's environmental footprint and increasing our positive impact on the community and the environment. The goals were highlighted in our most recent annual report, but given the importance of the work, I wanted to call special attention to them today. The new sustainability goals center around really 4 pillars: climate action, specifically to reduce greenhouse gas emissions; water stewardship; circular economy; and our supply chain. We recognize the increased importance for organizations like Brown-Forman to play a leading role in the environmental stewardship and look forward to sharing our progress against these goals in the years to come.

In a moment, I'll hand the call over to Leanne who will provide more details on our first half of fiscal '22 results as well as our recent capital allocation actions. But before I do, on behalf of the Brown-Forman Board of Directors and executive leadership team, I want to say thank you to the 4,700 Brown-Forman employees around the globe who give me a multitude of reasons to be thankful as we mark the end of another calendar year. As a company, we've lived our values of integrity, respect, trust, teamwork and excellence each and every time we've had headwinds and challenges come our way.

The last few years have not been easy, but it has been a beautiful thing to watch how our teams have responded and produced solid business results. By living these values to people have enabled our business to be resilient and I believe that because of our people, Brown-Forman will get better year after year and continue to thrive for generations to come.

Leanne, I'll now hand the call over to you.

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. As Lawson reviewed our headlines for the first half, I will provide additional details on our business results and our outlook for fiscal 2022. Starting with the top line. Reported net sales were up 9% in the first half of the fiscal year compared to the same period in the prior fiscal year. This growth was driven by favorable price/mix, higher volumes and the positive effect of foreign exchange, partly offset by an estimated net decrease in distributor inventories and the effect of the sale of Early Times, Canadian Mist and Collingwood brands during the first half of fiscal 2021.

The decrease in distributor inventory is primarily due to the supply chain disruptions Lawson mentioned and that I'll address in more detail momentarily. From an underlying net sales growth perspective, we experienced broad-based growth across all of our geographic clusters of the U.S., developed international markets and emerging markets as well as our travel retail channel.

Starting with the U.S. business, which represents approximately half of our underlying net sales. For the first half of fiscal 2022, underlying net sales grew 6% due to higher volumes as well as positive size and channel mix. Jack Daniel's Tennessee Whiskey was the largest contributor to growth, fueled by higher volumes and a favorable channel mix shift with the reopening of the on-premise channel. Recent trends observed by mobility and open table reflect a stabilization in the on-premise channel just below their prepandemic levels.

Consumer premiumization trends continue to propel our premium bourbons led by Woodford Reserve and Old Forester, both with their strong double-digit underlying growth rates, along with strong consumer demand for our tequila brands resulted in higher volumes of Herradura and el Jimador. This growth was partially offset by lower volumes in the off-premise channel due to strong prior year comparisons.

Supply chain disruptions, particularly for the Jack Daniel's flavors and Woodford Reserve also had an adverse effect on our first half results and reduced inventory levels. These disruptions impacted our finished goods inventories along with inventories at our distributors and retailers. In the e-premise channel, our market share remained slightly above 2% and well above prepandemic levels, even as the on-premise channel reopens and consumers began to return to in-store shopping.

Developed international markets collectively delivered strong underlying net sales growth, up double digits in the first half, with broad-based growth across the markets despite supply chain challenges. This growth was largely driven by the reopening of the on-premise as well as a rebound of tourism in some markets.

The Jack Daniel's family of brands experienced strong growth driven by Jack Daniel's Tennessee Whiskey, high single-digit volume growth led by markets such as Germany and the U.K., where the brand is gaining share. The brand also grew in Spain as tourism returns and

Korea where whiskey consumption shifted to international brands. Jack Daniel's ready-to-drinks experienced strong volume growth in Germany, where we continue to be a category leader and the U.K. These gains were partially offset by lower volumes in Australia due to strong prior year comparisons. Jack Daniel's Tennessee Honey grew volume double digits, fueled by gains in France, Czechia and Korea, and collectively, the Jack Daniel's super-premium brands, Gentleman Jack and Jack Daniel's Single Barrel grew volume low single digits as they were significantly impacted by supply chain challenges.

In addition to the Jack Daniel's family, collectively, our super premium brands delivered very strong double-digit underlying net sales growth. As Lawson mentioned, we continue to invest in these brands through our emerging brands group in Europe. Collectively, our emerging markets continue to rebound against easier comparisons with strong double-digit underlying net sales growth driven by the growth of Jack Daniel's Tennessee Whiskey in Turkey, Brazil and Chile, the continued launch of Jack Daniel's Apple, most notably in Brazil and Chile, and collectively, our full strength tequila brands grew double digits in Mexico as the down trading trend shifted back towards premiumization, which more than offset the strong prior year comparisons of New Mix RTDs.

While New Mix is down year-over-year, the brand is performing above its prepandemic levels. And from an innovation perspective, we continue to innovate in the RTD category and recently launched el Jimador Seltzer in Mexico in October.

Finally, our Travel Retail business continued to experience a strong rebound as we cycled against significant declines during the early days of the pandemic. Volumes continue to remain below their prepandemic levels as international airline travel and the cruise business have not fully recovered.

Moving on to gross profit and gross margin. In the first half of the fiscal year, reported gross profit increased 9% with underlying growth of 12%, in line with our underlying top line growth. and gross margin was down 10 basis points year-over-year. This represents an improvement in gross margin in the second quarter compared to the same period last year. Consistent with last quarter, we continue to navigate the impacts of global supply chain disruptions and input cost headwinds.

As we shared last quarter, our supply chain disruptions have largely been driven by glass supply constraints. While glass supply constraints have eased in the second quarter, they resulted in a decrease in our finished goods inventory along with the inventories at both the distributor and retailer. These challenges have had a negative impact on our price mix in the first half of this fiscal year due to unfavorable product mix on our higher-margin brands include Jack Daniel's family of brands as well as Woodford Reserve. And similar to many other CPG companies, we have also experienced higher-than-expected logistics cost.

The input cost headwinds related to agave and commodity prices, largely grain and aluminum also continued throughout the first half of the year. Consistent with our last call, greater demand of our tequila brands, driven by the continued growth in the U.S. and a faster-than-expected rebound in Mexico has required a greater supply of agave. As a reminder, agave costs are below their peak, though easing at a slower pace than expected due to the higher demand within the category.

Turning to our operating expenses, we continue to support our top line momentum through our investments behind our iconic brands and our people. Our reported advertising expense increased 24% and on an underlying basis grew 23% in the first half as we lapped the impact of the early stages of the pandemic on-premise activations, consumer events, summer festivals and sponsorships were rescheduled or canceled.

Reported SG&A expenses increased 10% with underlying growth of 8%, driven by the timing of compensation-related expenses non-income tax items and the cycling of lower discretionary spend during the same period last year due to COVID-19.

In total, on a reported basis, operating income decreased 15%, largely driven by the effect of acquisitions and divestitures, primarily the gain on the sale of Early Times, Canadian Mist and Collingwood brands last year and the decrease in distributor inventories and on an underlying basis, operating income grew 13% for the first half.

The decrease in reported operating income combined with an increase in our effective tax rate resulted in a 24% decrease in diluted EPS to $0.89 per share. And finally, to our fiscal 2022 outlook, even with the volatility and potential resurgence of COVID-19 due to emerging variance, we remain confident in our top line growth momentum based on the continuing performance of our U.S. business, the collective strength of our developed markets, which performed well throughout the pandemic in the off-premise channel and should continue to benefit from the reopening of the on-premise channel and increasing levels in tourism.

In the aggregate, we still expect strong growth in our emerging international markets as well as Travel Retail as we cycle the effect of easier comparisons, they continue their path to recovery. And further, we do not expect our noncore business, mainly used barrel sales to have a material impact on our results this year. We also believe our portfolio remains well positioned to continue to benefit from growing premiumization trends.

Additionally, as we mentioned last quarter, given the strength of our brands, we are able to focus on value growth through revenue growth management initiatives and have increased price on a number of our brands in the U.S. including Jack Daniel's. We believe our ability to take price reflects the health and the investments we are making behind our brands as well as a more favorable pricing environment.

Based on our strong results in the first half of the fiscal year, coupled with solid consumer takeaway trends, we now expect underlying net sales to grow in the high single-digit range.

Turning to gross margin. We continue to manage through the unfavorable impact of global supply chain disruptions and have deployed a number of risk mitigation strategies to address the various constraints on our business. While we expect these disruptions to continue throughout the remainder of the fiscal year, we believe the impact will become less significant in the second half of the year. We believe this along with persistent cost headwinds related to agave, logistics cost and commodity prices will continue to have a negative impact on our gross margin.

We also believe we will have a modest impact from the removal of tariffs in the EU. The tariffs are scheduled to end on January 1, 2022. Therefore, the impact to the full year fiscal 2022 will be minimal, but it will be a tailwind. As a result of these factors, we still expect gross margin for the fiscal year to be flat or slightly down. The spirits category continues to take share from beer and wine, and we will continue to invest behind our brands to ensure we optimize our opportunity to gain share in the market. We expect underlying advertising expense to be in line with top line growth, which is consistent with our long-term philosophy.

We also remain committed to supporting our various strategic initiatives including our 3 new RTCs of Russia, Belgium and Taiwan, the continued expansion of our emerging brands team in select international markets and the increased investment in our digital marketing and e-commerce capabilities. Therefore, we now expect our underlying operating expenses, advertising and SG&A to be in the high single-digit range, and we now expect our underlying operating income to grow in the high single-digit range, in line to slightly below underlying net sales growth.

Lastly, we continue to expect our fiscal 2022 effective tax rate to be in the range of about 22% to 23%. As a reminder, the seasonality of our results are expected to be volatile for the remainder of the year, particularly our operating income as a result of unusual comparisons in our prior year.

Before I conclude my remarks, I wanted to briefly highlight our long-standing capital allocation philosophy that has produced strong results for our investors and allowed us to maintain a healthy balance sheet. As I shared during our Investor Day in September, our 4 guiding principles are: first, to fully invest behind our business; second, to pay increasing regular dividends; third, to opportunistically look for acquisitions that we believe create long-term value; and finally, to seek opportunities to return cash to shareholders in excess of regular dividends.

Throughout the pandemic, we thoughtfully and judiciously prioritized managed and allocated capital and emerged with an even stronger balance sheet. As we announced on November 18, the Brown-Forman Board of Directors approved a 5% increase in the regular quarterly cash dividend. We are proud to be a member of the prestigious S&P 500 Dividend Aristocrat Index, having paid regular quarterly cash dividends for 78 consecutive years and increased the regular dividend for 38 consecutive years.

In addition, Brown-Forman's Board of Directors declared a special cash dividend of $1 per share or approximately $480 million on our Class A and Class B common stock. We firmly believe our capital allocation philosophy, coupled with our strategic priorities will continue to drive superior returns over the long term.

In summary, we are pleased with the strong first half of the fiscal year. We are able to share these results today because of the strength of our brands and the commitment of our people, the strong and talented spirits that make up Brown-Forman. Over the last 20 months, our employees around the world have demonstrated the same high level of agility and resilience that we've seen exemplified throughout the course of our 151-year history. They have shown us once again that we can continue to build our brands, achieve our strategic ambitions and thrive in the long term, even under challenging conditions. All it requires is determination, perseverance and a commitment to ensuring there's nothing better in the market than Brown-Forman.

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

Question and Answer

Operator

Our first question comes from the line of Kevin Grundy from Jefferies.

Kevin Michael Grundy

I was hoping you could spend a moment on the U.S. market, which is obviously your biggest market globally. When I looked at the reported results, it appears that the U.S. declined in the second quarter, very strong first half of the year but declined a bit in the second quarter. Year-over-year comparison looks similar in the first quarter relative to the second and I understand you're working through some supply chain issues. But maybe just spend a moment on some of the factors driving the deceleration in the second quarter? And then relatedly, perhaps you have an estimate for depletions in the U.S. and/or all-channel retail takeaway? And then I have a follow-up.

Lawson E. Whiting

All right. Kevin. Let me step back as kind of we knew this question was coming a little bit. I want to give you a little bit of a longer story of what has happened with the Jack Daniel's family and then the also the impact on the rest of the portfolio really over the last 2 years.

So if we go back to fiscal '21, just a reminder, everyone, this is a global segment not U.S., I'll get to the U.S. towards the end. But just as we look back to fiscal '21, so the year that ended

April 30, 2021, Jack Daniel's Tennessee Whiskey sales were down 4% but Brown-Forman Corp. was plus 6%. So this was the year obviously that Jack Daniel's Tennessee Whiskey with its huge on-premise presence around the world went into decline.

I mean I think the good news or the positive news out of that or the positive takeaway out of that was that Brown-Forman has now got enough legs under the stool that when Tennessee Whiskey struggles a little bit, the company can deliver a plus 6. So we felt pretty good about that. Now moving forward, now moving into fiscal '22. The on-premise business in the U.S. really started to come back in a stronger way, sort of late spring, early summer, and Jack Daniel's Tennessee Whiskey came with that and had a very, very strong start to the fiscal year, as you mentioned. But then at the same time, as that is happening, the supply chain problems creep into our situation really in late spring, early summer.

And Jack Daniel's Tennessee Whiskey was the first to really feel it. And so we drew down inventories at the beginning of the year, really throughout the entire supply chain on a global basis. But eventually, that started to hit us harder. We started to have out of stock problems later in the kind of late summer, early fall. And we had to make some tough decisions.

And so what we did was prioritize. This is sort of, I'll say, August time frame, August, September time frame, where we said we have to keep Jack Daniel's Tennessee Whiskey moving and healthy particularly as the on-premises reopening again. And so the glass really got prioritized for Jack Daniel's Tennessee Whiskey, and you've seen pretty good performance out of the brand throughout even, I think, through the first half, and feeling pretty confident in the outlook even in the second half. But what happened with that, that has been so difficult was, in particular, the Jack Daniel's flavors in the U.S. Gentleman Jack globally, Woodford, which is primarily a U.S. brand also felt it, even Old Forester felt it.

So we began to -- those brands all began to soften really September, October time frame. And so a lot of you all that are looking at, say, NABCA data or Nielsen data that's coming through in that September, October time frame, especially as I said on the flavors. If you look at Schedule B in the earnings release, it has the distributor inventory column, you can see the difference between reported and underlying there.

And you can see there are huge numbers on there as we've really taken down inventories, particularly in the United States and we fought off these out-of-stock problems. Now that it's a long way of getting around of saying this or getting an important point across that the situation is improving now.

We do believe the worst is behind us. But it has been a challenging difficult situation in the last few months particularly if you take a brand like Woodford, just as an example or even gentleman Jack, the consumer momentum behind those brands is so strong that to have out of stocks just absolutely makes life very difficult. Our commercial teams obviously, are very frustrated with that whole situation. But as are the production teams and everywhere else, it is a massive effort inside the company to try to mitigate these challenges as best we can. And we're doing it.

And as I say, I think it's behind us. So you'll start to see improved numbers -- takeaway numbers going forward, particularly in the U.S. An important point to make on all that is all this is inside the guidance that we gave. So we were able to raise sales guidance even after fighting through all of these problems. So thank you for listening to me. That was a long answer to that but I wanted -- we needed to kind of get that out there before we get through the rest of this call, I think, because it affects everything.

Kevin Michael Grundy

No. It's very helpful color. If I could just squeeze in one more, and then I'll pass it on. I suppose the other sort of obvious question is this unwelcome new COVID variant. So I think any color that you can provide in terms of what saw on your business in the month of November, what you're seeing now, particularly in perhaps more channel sensitive areas that being on-premise, travel, retail?Anything you can share there, I think, would be helpful. I'll pass it on.

I mean, if I'm honest, it's been too soon to see anything particularly in November, it's just not impacting results right now. I mean the on-premise, you've all seen the numbers, the on-premise numbers are actually pretty good in the United States these days. It's not absolutely flying, but we have not seen degradation. I mean, I think -- I don't think -- well, let me guess -- I don't think the Omicron is having a big of an effect as really -- I mean I think the restaurants and the labor shortage and all the other challenges that the on-premise world is having that we've all experienced, I'm sure if you go out to dinner, is having a bigger limiting impact on the on-premise really than variants.

Leanne Cunningham

And then the only thing that I would add is over time for this last 20 months, our teams and our brands have figured out how to navigate through different levels of restrictions in different channels, and we have figured out a way how to continue to get our in the hands of our consumers through at all.

Operator

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

Andrea Faria Teixeira

I wanted to just go back to the tariff release. This is like something that will impact, I was surprised that didn't bring, of course, you had of different pressures on the cost side. But it sounds to me like keeping the margin flat with the 4-month benefit you have ahead of you?

Like can you parse out what type of pressures that you're having or you finding the need to invest more in pricing or promo or anything that we may not be aware of? And if you can give us like a little bit of color into 2022 -- into fiscal '23 or calendar '22, how are you going to be seeing that play out, that reinvestment being used for marketing?

Leanne Cunningham

Okay. So I'll take that one, and I'll start with. I think it's great that you have the question out on the board and how we think about tariffs and the great news of 3.5 years and that they have now been removed as of January 1. What is removed as of January 1 is the European Union portion of the tariffs. We continue to have tariffs on American Whiskey brands for the United Kingdom.

So with that, when you think about the information that we've put out previously, our European Union portion of that is approximately 80%. And then where you think we are in the fiscal year, that starts on January 1, which only leaves us 4 months of our fiscal year. We do have inventory in the markets that we have to work through.

And then with the remaining months in our fiscal year not being the largest volume month than we don't get, like we said, a modest positive impact in this fiscal year. And to your point on '23, we are very excited about looking forward. But what for today and for what we need to be focused on is delivering to all of our shareholders, the outlook that we just issued today, which is high single digits on both the top line and the bottom line as we move forward. So we've got to focus on delivering that. But as Lawson mentioned, we now are incredibly excited that this tailwind that has been a tailwind for -- this headwind, that's been a headwind for far too long, is now turning into a tailwind.

Lawson E. Whiting

Did you follow the math that we -- it just doesn't affect much in this fiscal year, largely because of the inventory that we've got to March through before hand. So you're only getting a month or a couple of months' worth of benefit.

Leanne Cunningham

And as it relates that to '23, we generally give that guidance as we get into the fourth quarter of this fiscal year.

Andrea Faria Teixeira

No, that's fair. No, I did follow. And then the other thing I wanted to just about check, the glass shortages that you said they are better now. Could you give us an idea how like how you are in terms of meeting that demand and as we go -- we could go through the rest of your fiscal year, what are you embedding in terms of the impact going forward for the lack of the -- we can probably do the math here on the depletions, and I saw some of your SKUs down 26% in inventory. But as we look through the math when we take a picture again at the end of the fiscal year, would you think that the second half would be still impacted? Or do you see that kind of normalizing already by the fourth quarter?

Leanne Cunningham

Yes. As we mentioned in our scripts, we do believe that our glass supply constraints are easing. We are moving more now into the position of replenishing the supply chain and getting the cases to the market through every mode of transportation that's available to us to get our brands again in the consumers' hands.

So as it relates to how we're thinking about it for the full year, we have that full -- we have everything that we can estimate built into our full year guidance. We have set it flat to slightly down. But really, it's really all coming around -- we're getting closer to flat. But I do think it's prudent that we stay slightly down in the inflationary environment that we're in, and we're seeing inflationary costs, as we mentioned, on grains and aluminum and energy and even for some of our wood. So again, just to be prudent, we established that guidance last quarter. We continue to believe that gives the guidance to give, though, with the small positive impact of tariffs, we are moving back towards closer to flat.

Operator

Our next question comes from the line of Vivien Azer from Cowen.

Vivien Nicole Azer

I wanted dig into that just a little bit more as it relates to your pricing posture, particularly in the U.S., Lawson, we talked about like reduced focus on pricing for the first time in 8 years in this marketplace. But I'm wondering whether you had to adjust those plans at all given some of the glass shortages that impacted Woodford and noncore Jack variants.

Lawson E. Whiting

Yes. I mean, Vivien, the supply chain impact on pricing, I actually would call that relatively minimal. What we've been talking about, I think, in the last couple of quarters, and I'll bring it up again now is just as you mentioned, there hasn't been a lot of pricing really, not only in the U.S. but globally in the world of spirits over the last really decade. And we want to see more balance to that for sure, both within volume and price.

And so I mean I think as you've heard us talk about before, we've put a lot of money into people and in the systems and really trying to grow our capabilities in revenue growth management and those become part of the story as to how we intend on getting our price up. In some cases, just taking a frontline price increase too. So it's sort of all in with all the tools that we have. I mean, I think given the inflationary environment that we're in right now that we're all seeing, it would certainly be a missed opportunity if we can take price right now.

And so we are doing it. You're not really seeing it in the numbers yet. It's just -- that's just a timing thing. I think you'll start to see it come through as we get into the latter half of this year and into next summer and really trying to change the mentality even within the company to focus on value share, focus really on our super premium brands, make sure our innovation pipeline, all those things all add up together to try to get a better price/mix balance in everything that we do. So yes, so I mean, it is a bit of a mindset difference, I think, within the company that just really hasn't been there, as I said, for 8 or 10 years.

Vivien Nicole Azer

Okay. That's encouraging that you're sticking with that posture. My follow-up question is on A&P spend. So I heard you guys loud and clear should grow in line with sales. But if we look backwards, A&P on an underlying basis has grown ahead of organic sales for the last four quarters. So as you think about the back half of the year and given the recovery that you're seeing in international markets, are you thinking about any kind of a geographic mix shift as you deploy those resources?

Leanne Cunningham

We're going to continue to invest maybe in where we see the opportunity for growth. And as you talk about the last 4 quarters, and we've talked about this, and I know you understand it, it's just the volatility of the actions that we took as we were entering into the pandemic, moved into the fiscal '21 at a very slow pace with the cancellation of a lot of advance and sponsorships and concerts and as they were closing down.

And then as we got into the back half of the year, we started to invest much more heavily. So not only are we comping against kind of the easier comps in the first half of this year. We're also investing at, I would call it, the more traditional seasonality balance across. But again, with our top line growth, we are able to invest at a higher rate, and we will put that back against the opportunities that we see.

And as Lawson mentioned, with our strong growth that we are having in the U.S. on an underlying basis. Of course, we'll continue to focus on the U.S. But then through our emerging brand groups in the European division, when we look at just really the strong double-digit growth that they are creating both from our super-premium American whiskey and our tequila brands, actually, albeit on a smaller base. That strong double-digit growth, we are continuing fuel the momentum there as well as our international markets where we made adjustments in the early portions of the pandemic. Does that help?

Operator

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

Stephen Robert R. Powers

Maybe shifting back to the supply dynamics at play right now. I guess can you first talk about how the low levels of inventory that you called out exiting 2Q, both in your own finished goods as well as throughout the trade might be impacting the business into and through the holiday period? Just any incremental challenges versus normal you might be managing through?

And then, I guess, maybe even more importantly, as things hopefully improve, and it sounds like they are, I guess, can you talk about what success looks like for the second half? Is it just being able to better keep pace with underlying sales demand? Or do you think you can actually make up ground and at least partially rebuild trade inventories as we progress through the second half set against what you laid out as your underlying sales growth guidance.

Lawson E. Whiting

Okay. So let me -- I'll take the beginning of it and Leanne will pipe in here. So in terms of supply chain and how it's impacting Christmas, I mean, it is clearly impacting right now. As I said, we have some out-of-stock problems in the U.S. that are uncomfortable and that we are trying to plug right now. We're all working very hard to have that happen.

Outside of the United States, the supply chain problems are not quite as severe, largely because they are Tennessee Whiskey led as opposed to the rest of the portfolio. And we've been able to supply those markets earlier on when we were tight. So it's not really a Christmas. We're not -- I say we're not worried, but we're less concerned about the international supply chain challenges right now. It is really a U.S. thing that needs to catch up. Look, there are going to be some lost sales.

We've said we've included it in the guidance, but clearly it is pinching us this year. The question is madly trying to get cases out of the shelf right now. I mean look it's December 8 or whatever it is, some of that, if you're not there by now, you're probably not going to get there. But I do think it will have some benefit, though, in the year-to-go period, too. I mean there's so much going on in this year-ago period as the comps get very, very difficult in Q4. There's also going to be some offset as we replenish distributors and retailers in the U.S. and really around the world also. So we'll see. We gave it the best guess we did in the guidance that we gave.

Leanne Cunningham

And I'll just add on. We talked about our risk mitigation teams and strategies and Lawson already mentioned that we took the glass supply that was available to us over these last few months and focused on prioritizing Jack Daniel's Tennessee Whiskey. And we also prioritized markets that had a longer supply chain with transit time. So as -- and we took every mode of transportation to prioritize getting cases first of Jack Daniel's Tennessee Whiskey over to our international markets, knowing that in the U.S., we still had the month of November and some of December to get those cases produced and with a shorter supply chain, hopefully still out to the market and to the shelf.

Lawson E. Whiting

Yes. Air freight in cases of Jack Daniel's to Europe is never -- it's expensive. So that's one of the things you're seeing in the recent gross margin expectations. If we wanted that to be better at this stage, we did not expect we were going to be air shipping as much as we have. Thankfully, this is kind of a onetime thing, and it's going to get better in the year ago period. We won't be in the place where we need to air ship or I think we're pretty much already past that now.

Stephen Robert R. Powers

Yes. So that's helpful. And I guess -- I guess my question, and I know -- I appreciate you don't guide to trade inventory swings. But when you talk about improving and things getting better and replenishment in the back half. Is that replenishment to the consumption so that you can -- your underlying demand accelerates to consumption and the inventories keep pace? Or do you actually think you can replenish trade inventory and actually run net positive on that in the back half?

Leanne Cunningham

Yes. I mean, at this point, we are totally focused on -- I'm working with all of our partners to continue to get all of the input materials that we need to navigate through the logistics challenges to get our inventory to the distributors and then even at distributor levels around the world, they're also facing workforce challenges to get those cases to the market.

So there is a lot in the supply chain. I know you're aware of that with others that you're speaking with. But it's just important for us right now to make sure they are getting the cases extent that we can to the market and over the back half, and it will probably be even a longer period of time than just the second half of our year to rebuild, begin to fully replenish and rebuild our supply chain, but we are focused on getting those cases to the market first and rebuilding where we can.

Operator

Our next question comes from the line of Lauren Lieberman from Barclays.

Lauren Rae Lieberman

I had 2 questions. First I was just carrying on this conversation about supply chain challenges, apologies. But how might you compare your out-of-stock situation to that of competitors at this point where you've been even in the last couple of months?

Lawson E. Whiting

I mean, that's very difficult to estimate in terms of out of stock on the retail shelf because the data is just -- I mean, it's pretty tough to be able to get to that data. So I actually don't really know. I can -- and this is a bit anecdotal. But we know everyone that many competitors are having some of the sales that we are. I would -- the one place you can look that I think that was interesting was about 2 months ago, the Pennsylvania Liquor Control Board publish a list of all the brands that they had that they were going to limit to purchases of only 2 models. And Jack was one of them, but as were -- it's really the big brands, small brands don't -- I mean, they're smaller. They don't have -- they're not going to run out as fast, they're not turning as fast. And so we were able to pinpoint -- the big brands that we compete with, a lot of them are all having the same problems we are. I know that doesn't perfectly answer your question, but.

Leanne Cunningham

Yes. And I think for us, too, and I think we try to -- we're seeing it a bit more clearly now. We did say it in the last quarter is we feel like for us, we have an additional challenge with the extent that we had glass supply quantity and quality challenges. With that challenge, we had to utilize our finished goods inventory that we had stored and warehouses around the world to meet consumer demand, while we were working with our partners to get a higher level of glass supply in. So it's just kind of working through that gap in our supply chain.

And so I would say we went into logistics challenges created by the pandemic with lower inventory levels than likely some of our peers did. And again, to Lawson's point, that is we don't have their information, so it's really hard to estimate that.

Lauren Rae Lieberman

Okay. I understand. I guess one thing I've been thinking about is the degree to which scarcity ultimately benefits pricing, and that's inclusive of promotions and particularly in your categories. We're not talking about laundry detergent here, right? So I know you've been talking in the past about how you've invested in data analytics and revenue growth management capabilities. It may be premature to answer the question because I know or even think about it, because I know pricing is really just going in the U.S. on Jack Daniel's. But how do you think that -- is it possible that the promotional environment changes, that consumers that perhaps had gotten accustomed to buying Jack and Jim Beam, for example, on deal have been weaned off of that over the last 2 years. I'd be curious to get your thoughts on that.

Lawson E. Whiting

Well, I like that thought I think what is -- and really in the short term, I didn't say this previous caller asked the question. But I mean there has been a reduction in discounting or promotional levels really, I mean, I think, globally over the last few months. So there's no reason to put something on promotion, if you're hedging on to having a stock problem.

And so that's been the shortest term impact. But I mean longer term, have we reeducated the consumer a little bit? I think it probably is too early to make that call. But I do think that --

look, I mean, there is inflation and there is pricing coming through on so many consumer categories right now that consumers aren't really going to have an option.

I mean I think as so many of the brands, and we expect to see the industry -- and we've heard comments from -- even from other competitors that now is the time to rebalance a little bit the volume and the value trends.

Lauren Rae Lieberman

And I guess in that vein, I think you spoke earlier on the call and in the past about spirits ongoing share gain from -- at the expense of beer and wine but something that's been really interesting over the last couple of months is that as reopening has happened, you've seen more pressure from a category standpoint -- significantly more, I would argue, volumetrically on beer and wine.

People as they shift back to on-premise, you drink less at the on-premise occasion. Do you think it more of as an occasion rather than everyday while we were all locked in our houses. But spirits volumes have remained pretty resilient. So any thoughts you might offer things that you're seeing in your consumer research that are driving that different outside of just this long-term trend of share gains for the industry?

Lawson E. Whiting

Yes. I mean, you bring up what I think is one of the more most important sort of things that's happening these days is that we're trying to measure and I'm sure you are, too, and that's really is the U.S. spirits market, is it at a stepped-up growth rate? It certainly was, as you mentioned, for sort of the 12 months -- the first 12 months of the pandemic. But now we're in the second -- we're closing out the second 12 months.

And the trends that we're looking at are still very strong on a -- particularly, I'm just staring at a 2-year stack, which I encourage everyone to do that as opposed to the 1 year because I think within Brown-Forman, particularly on a 1-year basis, you're going to be looking -- you kind of get apples and oranges mixed up because we did not fall nearly as far as our competitors did at the beginning of the pandemic. And so our comparisons are a little bit more difficult now.

So that's why we're internally really focused on that on the 2-year stack. But if I look at NAFTA data, I mean, TDS is still up there in the sort of low double-digit range, and it's not slowing down. In fact, 3 months is better than 12. So I mean, you've got some real strong trends in spirits, it seems like it's retained its share gains that it made during the pandemic. And just the question is how long can it hold it? I don't expect double-digit growth necessarily to hold forever. But a U.S. spirits market that used to be maybe a 4.5% or 5% growth market, is it 6 or 7 now. And I think we'll see as the next few months and quarters sort of go by. But right now, it feels pretty good.

Operator

Our next question comes from the line of Sean King from UBS.

Sean Roberts King

I guess with the capital allocation, is there anything that you can do to invest in having adequate glass supplies for future periods of outsized growth? Or is this really a transitory issue that is more related to the quality of the glass?

Leanne Cunningham

It's the latter. It really is a transitory issue. And as we are investing, I would say, in extending partnerships broader across those that do produce glass so that we have a broader base to navigate any continued disruption that might be out there in the future. But from a capital allocation perspective, I think that it would be outside of our core competency and our best path forward is to just ensure that we have a broader network by which to source all of our materials.

Operator

Our next question comes from the line of Bryan Spillane from Bank of America.

Bryan Douglass Spillane

I just had 2 -- maybe just 2 more, I don't know, clarifications or follow-ups. So just this whole conversation that we've had earlier around I guess, underlying sales versus reported sales and whether we can catch up at all some of the inventory. So I just want to make sure I'm hearing it correctly because you've given the revenue guidance on underlying sales, but it sounded to me, Leanne, in answering your response to Steve Powers' question. It just seems like we're not quite sure, and there's a possibility that your you'll effectively undership consumption, right? That underlying sales will still be ahead of reported, again, forgetting about currency, just because we're still not sure if we can rebuild all of the inventory between now and the end of the fiscal year. So I just want to make sure that I heard that correctly.

Leanne Cunningham

You did. Yes, it could carry into the next fiscal year, but our ambition would be to get as much of that replenished before the end of the fiscal year, but we do believe it will take a bit longer period than that. You did hear that correctly.

Bryan Douglass Spillane

Okay. And then related to that, just the -- your advertising spend is going up versus what you -- what was in the original guidance. And I guess question was just if we're having issues keeping product in stock, does it make a lot of sense to increase advertising? Like it is stimulating demand there's product scarcity, I guess, like does the advertising increase at all exasperate the problem potentially?

Lawson E. Whiting

Well, I mean, look, advertising has just got such a longer-term outlook than stimulating current quarter sales. And I just -- I probably wouldn't go there. I mean we're thinking more. I mean the algorithm or the guidance, I think we've given around advertising expenses being largely in line with underlying sales is something not just for next quarter but for the upcoming years. And so we're not thinking really we're going to cut back based on the suppliers, the supply chain challenge.

Leanne Cunningham

Yes, because we do believe that is temporary in nature. And then I would just add you, we just celebrated our first year with the global Jack Daniel's Tennessee Whiskey make account campaign. We're continuing to invest in expanding that across Gentleman Jack and the rest of the flavors. Again, we believe this is a long-term endeavor, and we're continuing to allocate -- reallocate dollars to broad reach media to continue to reach the consumers. But to Lawson's point, it's going to -- it's building for the long term.

Bryan Douglass Spillane

Okay. And then just the last one, and this is maybe more of a follow-up to Lauren's question earlier is we're at a point where we're beginning to move maybe consumers off of price points, right, that were perceived as "value" right, because prices are moving. Over time, is there an opportunity to also maybe introduce different pack sizes in order to maybe go smaller at a higher price per unit to drive some more revenue mix, revenue management like we've seen in and maybe some other categories. Just curious, with the landscape kind of changing, does it create some opportunities maybe to create some value with maybe introducing some different pack sizes?

Lawson E. Whiting

I mean, yes, part of revenue growth management, as you mentioned, we do -- look, the small sizes are big and profitable part of the business for us. I don't know if you're referring to the potential for the 750 to turn into a 700 in the U.S., that would be an opportunity -- something like that could happen. And I know a lot of people are looking at that right now.

Bryan Douglass Spillane

That was the type of thing I was thinking of -- some of the subtle change like a 750 to a 700 ml could have some pretty material margin -- positive margin implications. I'm just curious if there's real room to have that type of lever, if you will.

Lawson E. Whiting

Yes. I mean, I don't I don't know. I've not -- I don't -- I'm going to give you a little bit of a gas in that the Jack Daniel's franchise largely plays in pretty much all the size prices that you can legally sell in the United States.

But the other brands have less of that. And so you could see a little bit more introducing, say, on Woodford, which is a much more expensive product, the smaller sizes, the 375 for instance, those kind of things can be important or more important.

Leanne Cunningham

And one of the things also to as Lawson said, it's going to be about the brand and the brand specifically and where the consumer is. And if we have opportunity where the product sets in the store, then it's something that we would take a look at.

Operator

Thank you. At this time, I'm showing no further questions. I would like to turn the call back over to Sue Perram for closing remarks.

Susanne J. Perram

Thank you. And thank you, Lawson and Leanne, and thank you to everyone for joining us today for Brown-Forman's Second Quarter and First Half of Fiscal 2022 earnings call. If you have any additional questions, please contact us. Brown-Forman has been making spirits bright since 1870, and we'd like to wish you all a safe and wonderful holiday season. With that, this concludes our call.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.