Brown-Forman Corporation, Q1 2023, Earnings Call 2022-08-31

Presentation

Operator

Good day. Thank you for standing by. Welcome to Brown-Forman's First Quarter Fiscal Year 2023 Earnings Conference Call. — ***Operator Instructions*** — Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Sue Perram, with Investor Relations. Please go ahead.

Susanne Perram

Thank you, and good morning, everyone. I would like to thank each of you for joining us today for Brown-Forman's First Quarter Fiscal Year 2023 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 except as required by law, the company undertakes no obligation to update any of these statements, whether due to new information, future events or otherwise.

This morning, we issued a press release containing our results for the first quarter fiscal year 2023, in addition to posting presentation materials that Lawson and Leanne will walk through momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations.

In the press release, we have listed a number of the risk factors 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. As we began fiscal '23, our momentum continued, and we delivered another quarter of double-digit top line growth on both a reported and organic basis. We experienced strong consumer demand driven by increased travel and tourism, the gradual reopening of the on-premise internationally as well as sustained premiumization trends.

In addition, as we indicated on our last conference call, in the first quarter, we benefited from an increase in distributor inventories as we continue to recover from supply chain disruptions and constraints that began impacting our results in the prior fiscal year. Supply chain disruptions continue to affect our business during the first quarter of fiscal '23. While our glass supply improved, overall supply chain logistics and transportation continue to be constrained, which impacted our route to market and increased our costs.

As some headwinds turn to tailwinds, our gross margin expanded with favorable price mix and the removal of tariffs more than offsetting increased costs and the negative effect of foreign exchange. This improvement in our gross margin enabled us to further invest behind our brands and our people, while growing our bottom line ahead of the top line.

Overall, I'm very pleased with the start to our fiscal year and remain thankful to our Brown-Forman employees for their continued focus on growing our brands throughout the world.

So this morning, I'll provide a few more details on the quarter, and then I'll turn things over to Leanne. Our reported top line growth increased 11% with organic growth increasing 17% after adjusting for foreign exchange headwinds. Organic net sales growth in the quarter was driven by continued strong growth for Jack Daniel's Tennessee Whiskey, Woodford Reserve and the Jack Daniel's RTDs. Jack Daniel's Tennessee Whiskey remains the lead driver of our growth as the brand continued to deliver double-digit growth with an organic net sales increase of 21%, driven by strong consumer demand, higher pricing and favorable channel mix.

Second, our super-premium American whiskey portfolio increased organic net sales double digits. Woodford Reserve led this effort, growing organic net sales 39% and reaffirming the strength of the trademark. As glass supply constraints ease and we increase our bottling capacity, we were better able to meet consumer demand for Woodford Reserve.

Also in May, we launched the first super premium Jack Daniel's line extension in a quarter of a century. The new Jack Daniel's Bonded Tennessee Whiskey and Jack Daniel's Triple Mash Blended Straight Whiskey are the first 2 permanent expressions in the brand's new Bonded series, and they're off to a great start. The products are currently available in the U.S., France, the U.K. and Italy and will continue to roll out internationally. These whiskeys are another opportunity for both our friends and new drinkers to explore and discover everything Jack Daniel's have to offer.

Jack Daniel's RTDs, which grew organic net sales 17% were the third largest contributor to overall company growth, fueled by the consumer trends of convenience and flavors. Leading this growth is Jack Daniel's & Cola, which gives us continued confidence in our global agreement with The Coca-Cola Company to deliver the iconic Jack & Coke cocktail as a branded ready-to-drink adult beverage. We're on track to launch the Jack Daniel's & Coca-Cola RTD beginning in late calendar '22 in Mexico. We look forward to sharing more about this exciting agreement between 2 global American icons in the quarters and years to come as it expands to markets throughout the world.

The rest of the Jack Daniel's family also delivered solid results, led by a double-digit organic net sales increase collectively from Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Fire, particularly in the U.S., as the glass supply constraints have eased.

Beyond our American whiskey portfolio, organic net sales for our full strength tequila portfolio declined 3%. Supply disruption mainly related to glass for Herradura in the U.S. and Mexico, as well as difficult prior year comparisons in the U.S. were significant contributors to this performance. Demand, particularly in the U.S., remains very strong, but glass supply challenges and continued stable but elevated costs for agave have slowed our profit growth.

New Mix performed well as the RTD category in Mexico is growing and the brand is increasing share. So — ***indiscernible*** — built upon its momentum as the continued reopening of the on-premise channel drove a double-digit increase in organic net sales in our scotch portfolio, led by GlenDronach and Benriach also produced strong results.

Earlier this month, we announced an investment of over GBP 30 million in the GlenDronach distillery to significantly increase production capacity. Based on the latest IWSR data, global demand for the GlenDronach has tripled since 2016, the year that we acquired the brand as whiskey commissures around the world discovered the distilleries award-winning single malls. We believe this investment will steward long-term future growth of the brand.

Leanne will go into depth about our results in each of the geographic divisions, but I was pleased to see broad-based growth across all geographic clusters in the Travel Retail channel.

Also in the first quarter of fiscal ’23, our reported gross profit increased 13% and our organic gross profit growth was 21%, both ahead of the respective top line growth rates. While we experienced some headwinds in the form of a negative foreign exchange effect, higher costs related to supply chain disruptions and higher input costs due to inflation, they were all more than offset by tailwinds, including favorable price mix and the removal of the EU and U.K. tariffs on American whiskey. This combination of headwinds and tailwinds resulted in 80 basis points of gross margin expansion in the quarter.

It was this time last year that we shared our plans to increase prices in the U.S. on the majority of our brand portfolio as part of an overall strategy to increase prices more consistently year after year.

At the conclusion of the first quarter, nearly 90% of the price increases for fiscal ’23 have been executed, and we have seen retail shelf price changes reflected in almost 2/3 of the United States. Based on Nielsen data, Brown-Forman remains a price leader with 2.7% pricing growth outpacing total distilled spirits of around 2%. We continue to utilize our revenue growth management tools to evaluate pricing opportunities, not only in the U.S., but also internationally. We believe the health and relevance of our brands, as well as our continued brand-building investments will allow us to successfully implement our long-term pricing strategy.

In summary, we had a strong start to the fiscal year and remain optimistic as we look ahead, even as the global macroeconomic and geopolitical environment remains volatile and uncertain. This optimism is grounded in our success in both the short and long term. We've been through challenging times and conditions over the last 3 years, as well as the last 152 years. We've been tested, yet we've remained resilient. We have experienced adversity, yet we have continued to grow.

Brown-Forman has endured because we have some of the most attractive spirits brands in some of the most desirable categories, and we continue to innovate and expand our portfolio. We've thrived because of the bold and diverse perspectives of our people, which allow us to think creatively, innovate constantly and grow consistently.

I want to thank each and every one of them for delivering the results that we are sharing with you today. They give our company character and complexity, purpose and perseverance, agility and authenticity, and I am greatly appreciative.

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

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. As Lawson reviewed our headlines for the quarter, I will provide additional details on our business results and our outlook for fiscal 2023. First, I will share our top line results by geographic cluster. Developed international markets collectively delivered strong organic net sales growth, up double digits for the quarter. An increase in tourism and a return to the on-premise channel fueled broad-based growth across the markets despite continued supply chain challenges. Jack Daniel's Tennessee Whiskey was the largest contributor to growth, driven by Germany, Spain and Austria. Belgium also contributed to the growth as it has seen solid momentum since transitioning to owned distribution in January of 2022.

The Jack Daniel's ready-to-drink momentum continued with double-digit growth led by Germany and Australia. Consumers' desire for convenience and interest in the ready-to-drink category remains high in these markets, and we are gaining share. Aligned with our strategic priority of increasing focus on our premium and super premium portfolio, our emerging brands model that we recently began extending to some international markets delivered very strong double-digit organic net sales growth, driven by GlenDronach, el Jimador and Woodford Reserve.

Collectively, our emerging international markets continued to rebound with very strong double-digit organic net sales growth, driven by strong organic growth from Jack Daniel's Tennessee Whiskey, particularly in Turkey, Sub-Saharan Africa, Brazil and Chile. Jack Daniel's Tennessee Honey grew organic net sales double digits led by Chile, where the brand has more than doubled and New Mix growing strong double digits in Mexico. Growth was partially offset by lower volumes of Herradura in Mexico as the brand faced supply chain constraints and year-over-year declines in Russia due to the suspension of our commercial operations beginning in March of 2022.

The U.S. business remained strong, growing organic net sales 7%. This growth builds upon the 19% organic net sales growth delivered in the first quarter of fiscal 2022, which was fueled by the initial reopening of the on-premise channel. Woodford Reserve led the growth for the first quarter, with a positive impact from higher pricing and higher volumes as supply and capacity constraints eased. Also benefiting from an improved supply chain environment, Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Fire experienced volumetric gains. Growth was partially offset by lower volumes of Korbel and Jack Daniel's Tennessee Whiskey, which both lapped double-digit comparison in the same prior year period.

Despite the supply chain challenges, we estimate a net increase in distributor inventories positively impacted net sales. Although even with the increase in the quarter, we believe distributor inventory levels remain below their pre-pandemic levels. This is due in large part to transportation and logistics constraints, as well as increased consumer demand. We continue to monitor consumer mobility trends, and based on data from OpenTable and Google Mobility, the on-premise trends have continued to hover around pre-pandemic levels. This shift to the on-premise is continuing to impact off-premise takeaway trends as consumers have made the gradual return to restaurants and bars.

Our year-over-year takeaway trends have also been adversely impacted by supply chain constraints for brands such as Gentleman Jack and Jack Daniel's Tennessee Honey, Jack Daniel's Tennessee Fire and Jack Daniel's Tennessee Apple.

Finally, the Travel Retail channel continued its strong rebound, growing organic net sales 85%, led by increased Jack Daniel's Tennessee Whiskey volume as international airline travel and the cruise business accelerated in the May through July period. Our business in this channel has not yet fully recovered to pre-COVID levels, but continues to close the gap.

As Lawson shared the details of our gross margin expansion for the quarter, I will now turn to our operating expenses. Organic advertising expenses in this quarter compared to the same prior year period grew at a higher rate than our top line growth, largely due to the timing of our increased investments in the United States to support Jack Daniel's Tennessee Whiskey, Herradura, the launch of Jack Daniel's Bonded and Triple Mash and Woodford Reserve.

Our organic SG&A investment increased high single digits, driven primarily by higher compensation-related expenses and the investment behind our people to support our business needs in a post-pandemic environment, while continuing to leverage new ways of working.

In total, reported and organic operating income grew 19% and 32%, respectively, in the first quarter of fiscal 2023. These results, combined with a decrease in our effective tax rate, resulted in a 30% diluted earnings per share increase to $0.52 per share.

And finally, to our fiscal 2023 outlook. We continue to be optimistic as we look ahead even amidst the current volatility and uncertainty of the global macroeconomic and geopolitical environment. We believe our headwinds and tailwinds will remain largely the same through the remainder of our fiscal year and the strength of our portfolio of brands, supported by strong consumer demand and our strategic investments, will enable continued growth. And therefore, we are reiterating our full year fiscal 2023 guidance.

With the start of a new fiscal year, we have now cycled against the more volatile months of the pandemic, and believe we are seeing trends begin to stabilize. We remain confident in the collective strength of our U.S., developed and emerging international markets, along with the Travel Retail channel. We anticipate our results should continue to benefit from the continued return of tourism and the gradual reopening of the international on-premise channel, along with stronger pricing and innovation.

We do remain cautious given the potential impact of inflation and rising energy prices on consumer spending. I also want to reiterate that the seasonality of our fiscal 2023 results will be impacted by the abnormal seasonality of our fiscal 2022 shipments due to supply chain disruptions.

As you will recall, in the first half of fiscal 2022, distributor inventories did not increase ahead of the important holiday season as is typical, and we experienced stronger shipments in the second half of fiscal 2022 as glass supply challenges began to ease.

In the first half of fiscal 2023, we expect distributor inventories to continue to return to more normalized levels. Therefore, we expect our growth rate in the first half to benefit from the net change in distributor inventory. Our second half results will lap the increase in the net change in distributor inventory related to the rebuilding of our inventory position in the prior year period.

As it relates to our fiscal 2023 cost, the removal of the EU and U.K. tariffs on American whiskey remains a significant tailwind, while we continue to expect input cost inflation to remain a headwind. Also cost-related, our glass supply position has improved, though some challenges remain for some of our brands, particularly Herradura. We are continuing to partner with our current glass suppliers, as well as add new suppliers to address these constraints.

And similar to many other CPG companies, the overall supply chain, particularly transportation, logistics and freight, continues to be challenging. While we are actively working to navigate these challenges and their impact, we do believe supply chain disruption will remain a headwind for the remainder of the fiscal year.

Based on these headwinds and tailwinds, we are reiterating our reported gross margin guidance for it to expand slightly for the full year as our trajectory of expansion continues. Also related to our supply chain, we constantly search to identify continuous improvement opportunities to optimize both our supply chain and its related costs.

As we have shared with you during many calls, we have been progressing various initiatives to address the challenges related to the cost of wood. One such initiative has led us to the recent announcement regarding the decision to sell our Stevenson Mill in Alabama and Jackson Mill in Ohio to Independent Stave company. This sale is a part of a long-term agreement between Brown-Forman and Independent Stave to allow for the expansion and diversification of our supply chain network. Independent Stave is a dynamic family-owned cooperage company and is committed to environmental sustainability in its operations. All of these existing mills are Sustainable Forestry Initiative certified, and

Independent Stave, like Brown-Forman, is a founding member of the White Oak Initiative to support the long-term sustainability of white oak forest.

Although divesting part of our business is never an easy decision, there are significant advantages to this partnership, including broader-based sourcing, continuous improvement initiatives and cost savings from economies of scale.

We are also pleased that all employees impacted by the agreement will be offered positions with Independent Stave. It is important to note we will continue to own and operate our Clifton Mill in Clifton, Tennessee and both our Brown-Forman and Jack Daniel's cooperages.

For the last components of our outlook, the outlook for operating expenses remains the same. In addition to our philosophy of growing the investment behind our brands at a rate similar to our top line growth, as we have stated many times that when the EU and U.K. tariffs on American whiskey were removed, we would reinvest a portion of the relief back behind our brands. We are very pleased that in fiscal 2023, we are now executing against this additional investment behind our brands.

And as we shared last quarter, we will also invest behind our people and expect a continued rebound of discretionary spend to support our business needs in a post-pandemic environment. Based on these expectations, we currently expect our organic net sales and organic operating income to grow in the mid-single digit range for the full fiscal year. And we still expect our fiscal 2023 effective tax rate to be in the range of about 22% to 23%.

Lastly, we have noted the impact of foreign exchange on our reported results. The dollar continues to strengthen against many major currencies. Most notably, we are seeing the negative effect of the appreciation of the dollar against the euro and the Turkish lira. The guidance we provide is on an organic basis, which excludes the impact of foreign exchange. If we were to take the rates where they are today against the dollar for the remainder of the fiscal year, foreign exchange would be a headwind for us in fiscal 2023 on a reported basis.

In summary, and as Lawson stated, we have had a strong start to fiscal 2023, delivering double-digit top and bottom line growth on both a reported and organic basis. We remain optimistic as we look ahead and are confident in our ability to build upon this momentum and deliver consistent long-term growth despite near-term challenges and uncertainties. We believe our brands and our people are resilient as our results continue to reflect. As we often say, there is nothing better in the market than Brown-Forman.

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

Question and Answer

Operator

— *Operator Instructions* — Our first question comes from Andrea Teixeira with JPMorgan.

Andrea Teixeira

I wanted to just, first of all, congratulate you on the earnings. But just as you had is a 5% positive impact, which was called out in the last earnings call in the first quarter, it seems that you like your – the remainder of your fiscal year would then be the risk because of this is a strong number. Do you expect that inventory rebuild to phase out in the second quarter fiscal or you still have that benefit in your view? I know the CR numbers would still continue to be positive. But if you can elaborate a little bit more between consumption and depletion.

Leanne Cunningham

Andrea, this is Leanne. We are continuing to evaluate the time line to get back to normalization of our distributor inventories. Since the last fiscal year, and again, we talked about in our prepared remarks in the second half, we begin making significant progress on and rebuilding inventories. We're continuing to work very hard to rebuild those inventories. But at the same time, we're continuing to experience very strong consumer demand. And at the same time, we have also launched a new innovation.

So while we are working to improve our inventory position, and you can see there's a net increase in distributor inventory change that we are making progress, but we are facing challenges and strong demand. So we'll come back to you. We'll know more as we get into the second quarter to understand kind of what our exact timeline looks like. But we do continue to see benefit in the first quarter, as you stated.

From a glass supply perspective, supply chain, in general, we expect to be a headwind for the fiscal year. Our glass supply has continued to improve with our current supplier increasing capacity, we've broadened our supplier base, the Jack Daniel's facility is still bottling at record pace. But as also noted in prepared remarks, we continue to face challenges for some brands and some sizes and particularly for this quarter, it's Herradura and we have some capacity strength in the current supply chain, and we're addressing that currently by expanding our supplier base.

And then as we noted, kind of one of the challenges that will impact us through the remainder of the fiscal year is our ability to move the product into market through logistics and freight constraints because there is a high demand for the equipment. There's an imbalance of the equipment around the world. And again, that's coming with associated costs.

And in the U.S., which is our home market and our largest market, where we produce the vast majority of our product, we still face driver challenges and equipment challenges. So net-net, we're making progress, and we are working to replenish it. It does remain below pre-pandemic levels, but we're encouraged by the strong consumer demand. Lawson?

Lawson Whiting

Yes. I mean, I think, let me add a little bit to it, because it seems like glass supply, I mean, it has been a major problem for us for a year now. We actually first started talking about this. It was this quarter a year ago when we first really gave some detail on our glass supply situation. And so fast forward a year, I do think it's worth reviewing because it almost feels like every question we're going to get asked this morning, glass supply is part of the answer.

But a year ago, we really – we prioritized Jack Daniel's Tennessee Whiskey, so core Black Label, to allocate our immediate needs to Jack Daniel's Tennessee Whiskey as really the on-premise was opening up, not only in the United States, but around the world. And so we really prioritized Tennessee Whiskey to the detriment of practically every other brand in our portfolio. And so as the year went along, our demand has been very strong. I mean, demand for Tennessee Whiskey, which we believe is either the largest or certainly one of the largest on-premise brands in the world, the demand has just been outstanding, quite honestly. And so we had a big year last year, and it continued on through the first quarter of this year.

But as I said, brands like Gentleman Jack, the flavors, and now most recently, our tequila brands, have all suffered for it. So we've caught up with Jack Daniel's Tennessee Whiskey for the most part. I mean, it's taken a little longer because of the strong demand, but it's doing well, which Woodford Reserve had a great quarter, so we begin to replenish the inventories of Woodford around the world. Same thing on Old Forester. Gentleman Jack and flavors are not caught up yet, but they're getting better, but you'll see those. I think you'll see those trends improve in the upcoming few quarters.

And then as we said, Herradura really suffered over the last quarter. And that was, I would say, it was a bit of a surprise. But the Herradura, for 1 point to also make, Herradura grew by 90% in quarter 1 last year. So tough comps is also part of that answer. But certainly, the brand is suffering on their glass supply shortage that we're working very hard to try to fix, but it's not there yet.

Andrea Teixeira

Very helpful. If I can squeeze just one question on how consumers have been receiving the price increase. And if you're seeing – it doesn't look like you're seeing any down trade, but just this is the topic that we obviously spoke to all the companies this earnings season. If there is any price elasticity you've seen on the trade that investors should be aware of.

Lawson Whiting

Yes. I mean, look, we have pushed through our price increases. I think we said sort of 90% of the price increase is already reflected on the shelf. And we haven't seen the trade down. Now I'd stress a little caution in looking at our trends and then extrapolate those to sort of macro trends because of our glass situation. So that dominates over any sort of trade down or lack thereof really because it's not showing through in our numbers.

And when we look at TDS, we're not really seeing it. Obviously, it's a U.S. comment. But you're not seeing it really in the data there either. And so elasticities, I think the biggest piece of an elasticity question always is what are your competitors doing. And the competitors are also going up. And so for the first time in, I'll say, a decade, you're seeing some pretty good pricing throughout the industry and you're not seeing a lot of pushback. So we're able to get prices through. We're getting them through the retailers, that's on the shelf and consumers are still buying it. So feeling pretty good.

We use the term affordable luxury a lot, and I do think spirits is an affordable luxury where consumers they prioritize that bottle of Jack Daniel's. And to the detriment of a lot of other consumer products, you've seen a lot of the retail, of the big retailers in the

U.S. that have struggled with inventories, we're kind of the opposite where we don't have enough inventory out there. And it's pretty healthy. It's a good situation and the demand is still there.

Operator

Our next question comes from Peter Grom with UBS.

Peter Grom

So I kind of wanted to follow up on Andrea's question just around the guidance. And just given the strong start to the year, from a top line and margin perspective, it's just – the guidance seems to imply a pretty meaningful slowdown from here. And I guess, I just would be curious, is that simply just conservatism given the uncertainty on many fronts? Or is there kind of something you're seeing more real time in U.S. or other markets around the world that's giving you some concern here?

Leanne Cunningham

Well, and again, building – Peter, how are you? It's nice to hear from you. It's been a while. Building on what Lawson said from our inventory perspective, we really started as glass supply began to ease in our second half of last year. Our shipments were kind of above – they were above our depletion level, trying to get our inventory rebuild. So yes, we've had a strong start to our year, and we know that next quarter, we'll be comping one of our lowest performing quarter of fiscal '22.

But then at the end of fiscal '22, we had a 4-point benefit from those shipments. So when we have talked about, we will have a strong first start, first half of our '23, and that we will have to comp that 4-point benefit that we saw in the second half.

And then we also, again, as we said in our prepared remarks, we do remain cautious about how inflation and rising energy costs are going to impact our consumers. Will there be any macroeconomic or geopolitical events that similar to last March when we suspended our business? So again, that will be an impact in F ’23 is the absence of our business in Russia.

So from a cost perspective, we’ve talked about this a bit, we’re facing challenges, both easing on the glass supply, but then now moving to logistics and transportation, and then it will be our ability to get our product to market and to consumers, which we believe is possible. But it’s going to come at an increased cost, some of which we plan because we plan for inflation every year.

But one of the things that is different for us is that, as we talk about inflation, with the removal of the EU and U.K. tariffs on American whiskey, unlike many others, that will help us mute the impact of inflation and cost that we have.

So I don’t necessarily – it’s very early in the year. There’s a lot of year to go and a lot can unfold ahead of us. We are definitely optimistic and off to a strong start. But we know we have a strong back half of last year to come.

Peter Grom

That’s super helpful. And then I just – maybe following a different topic. Just the Coca-Cola and Jack Daniel’s partnership. Can you maybe just provide some more background on the partnership? Why both parties decided now is kind of the right time? And I know, I think Lawson, you mentioned the Mexico launch in the fourth quarter. But just any initial thoughts around timing in the U.S. and contribution to top line growth versus maybe cannibalization versus – for the existing ready-to-drink portfolio.

Lawson Whiting

Sure. So look, we are behind the scenes working through all of that right now. There’s obviously a ton of work that goes into launching a new product on the scale of what this is about. You're correct, we are looking at – it's only a couple of months away from launching in Mexico.

What we would – what we're going to do, I think, I prefer to do, is push this question off for another quarter. We will be more transparent with you all as we move into the rest of the fiscal year. We are still working behind the scenes on the cadence of launches, the level of investment, all but everything that goes with effectively a new product launch.

On a positive side, our Jack Daniel's & Cola, so not the Coke, but Jack Daniel's & Cola, is flying. I mean, that business is still really, really strong. And so that's part of the trick to this launch is how we remove those products from the market and replace it with Jack & Coke, and it's a little more complicated than maybe that might sound.

But this is still a very healthy business. There's a lot of – particularly in the U.S., there's a lot of competitors, not so much in the Coke side of things, but I mean, there's a lot of RTD interest these days, and there's a handful of brands that are doing really, really well. So we feel really good at this thing once we get it out there in the market, we'll be ready to drive some pretty significant demand. But I think we're going to wait another quarter before we sort of release a lot of those details.

Leanne Cunningham

And then the only thing I would add to that is we are really excited about the numerous opportunities that we believe that this product will have from a geographic expansion perspective and our ability to gain share with it as well.

Lawson Whiting

Yes. Obviously, the Coca-Cola system is so big. They cover the world. And our products haven't, we haven't even offered Jack & Cola in many, many parts of the world. So it's going to be an exciting thing for this company, and we're looking forward to it, knowing that most of that growth is really going to fall in calendar 2023.

Operator

— ***Operator Instructions*** — And our next question comes from Nadine Sarwat with Bernstein.

Nadine Sarwat

I got to kick off with my usual question on pricing. I remember on the last conference call, we discussed how you'd taken pricing across the board in the U.S., great to hear that I think you said 90% of that pricing for this fiscal year has gone through. Can you give us an update on your pricing strategy outside of the U.S. have been taken incremental price. This is especially in light of that inflationary environment.

And then one final question. Jack Daniel's Apple, I know you mentioned flavors being prioritized, but even if we take into account the changes in distributor inventory, we're at a fall of about 8% at an underlying level. Is there anything else we should bear in mind for the weakness in the quarter for this brand? Or is this a one-off because of those supply chain issues?

Lawson Whiting

Yes. Let me – I'll take pricing a bit and then maybe you can comment on Apple itself. I mean, yes, the pricing strategy that we are implementing is global. It's not just the U.S. And it's kind of similar numbers. Europe has been a very difficult pricing environment for a long time, but we are finally – we pushed through, successfully pushed through last year, and we'll continue to do it again this year. I call it that low single-digit pricing, That sort of 2% to 3% range is something I want to see for the foreseeable future. I mean, every year, not – we don't want to – we're not trying to go up 10% 1 quarter and then back off a little bit. It's trying to go slow and steady, and that's worked. It's worked so far.

And as I mentioned to the earlier question, I think a lot of it has to do with other brands are also going up, too. And so we're not seeing this sort of negative reaction either from the retailers necessarily. I mean, there's still, there's still challenges to partner with them to get prices up. But the environment is more conducive right now for many brands in our industry, not only Brown-Forman's to go up. Can you talk about Apple just a little bit?

Leanne Cunningham

And then to your Apple question, Nadine, it's really – it's in the process of lapping the final phase of its international launch last year. Demand has been high. And as Lawson mentioned, the prioritization of our products with the constraints that we have. It has been negatively impacted by that, but we continue to believe that its launch and its connectivity with consumers remains very high.

Nadine Sarwat

Got it. If I could just clarify on that pricing. Have you taken pricing yet outside of the U.S.? Or is that something you're hoping to do you have?

Lawson Whiting

No, no, no. We did it. Yes, we did it last kind of last cycle. So it would have been, I guess, Q2, for the most part, Q2, Q3 of last year, where the international prices all went through.

Nadine Sarwat

Got it. So you're planning on hopefully implementing similar pricing this fiscal year?

Lawson Whiting

Correct.

Operator

— ***Operator Instructions*** — And our next question comes from Vivien Azer with Cowen.

Vivien Azer

Sorry to go back to the glass supply, but Lawson, I think you've given us permission to dig in on that. So it seems like Herradura was clearly the surprise. And as I reflect back on your commentary around glass supply issues, last fiscal year, and just looking at Herradura's results where you rightly call out a very tough comp, how is it that Herradura was more immune to glass supply issues in fiscal '22? What changed this quarter?

Lawson Whiting

Well, I mean, it's just – it's where the glass is coming from and which plants are supplying the individual brands. And so, Herradura is one of the most important brands in our portfolio. And so it would have gotten some level of priority, particularly Herradura in the U.S. But as the demand, as I said, was 90% in Q1, the demand for several of our brands, not only Herradura, but that would be the most obvious one, where the demand was higher than we were forecasting.

And you can keep that going for a little while, but eventually, that runs into a problem. And so that problem showed its head over the last quarter, a couple of quarters really in Herradura as we are madly trying to find alternatives and find additional supply, but it's challenging. I mean, it really is.

Vivien Azer

Okay. That's helpful. And then maybe just to follow up on that. With the underlying gross margin disclosure, I was wondering, Leanne, if you could just kind of unpack even just like order of magnitude, the 180 basis points of cost pressure that you saw, like how much of that was glass versus agave versus other?

Leanne Cunningham

The largest driver of the 180 basis points of higher input costs is, a portion of that is glass pricing, as we – glass prices as we have the commodity inflation on natural gas. I would say a bigger piece of it right now is corn and agave. And I'll explain the agave piece in a moment. But for corn, the corn futures, they've moderated throughout Q1. And as we – it's stabilizing as we look out for F'23, but it is stabilizing at a place that is approximately 20% higher than last year.

So again, this is where in Q2. We'll know more about the harvest as it has been impacted by the weather, what the quality of it will be supply/demand, and again, the harvest will be coming in soon. Another thing associated corn is the increased freight costs due to fuel.

For us, agave is going to be a little bit of a headwind this year. Now, and I want to make sure that I'm clear, is the external agave prices have remained stable between MXN 27 and MXN 29 per kilo. Right now, we're seeing prices at the top end of that range. But for Brown-Forman, it's going to be the mix of what percentage we source from the external market versus what we have internally grown ourselves. And with the balance between what our inventory of agaves are that are ready to be harvest versus our demand, we're sourcing externally at a bit of a higher mix than what we would have last year.

So there's a bit of that change impact there. But the pricing for external is stable. So really for us, it's, I would say, corn and agave are the 2 biggest. We'll know more for corn as we get into the harvest. And we do have small inflationary increases on the cost of wood and natural gas is above it. So is there anything else I can provide to you on that?

Vivien Azer

No, that's really helpful.

Operator

— ***Operator Instructions*** — And our next question comes from Chris Pitcher with Redburn.

Chris Pitcher

I have a couple of questions on extending the Jack Daniel's brand. It sounds from your comments, Lawson, that you're still comfortable with the flavor extension strategy and there's more growth to go for in Apple. It feels like Honey perhaps has sort of achieved sort of critical mass. Should we expect you to be sort of working on further extensions beyond Apple? Or do you think the flavor story is perhaps playing out and the focus is more now more towards extending the premium extension for Jack Daniel?

And as a follow-up to that, I mean, looking at Bonded and Triple Mash, what sort of price premium do you think Jack Daniel's can move to and still achieve meaningful volumes? Because you have tried to take the brand up the price ladder before, and it runs into resistance. Have you – are you targeting existing Jack Daniel's consumers to trade them up? Or are you now going after more premium whiskey consumers?

Lawson Whiting

Well, to the second half of your question, the answer is both. The Bonded series is to say we haven't done an ultra-premium or super premium line extension in a long, long time. It's really since Gentleman Jack and some of the single barrel expressions over the years. So we are we feel really good about the initial takeaway on these innovations has been very strong, and we feel very good about that. It's getting really positive reviews. And at that sort of $29, $30, $31 price point, there is a real market for Jack Daniel's consumers. And so we feel pretty good about that.

As far as the flavor side of things, I mean, certainly, Honey, Honey has been a home run for this company over the last 10 years. And Apple is experiencing its own sort of issues, not only lapping some of the launching, but the Apple launch is just the timing, whether you talk about the U.S. or international, was just terrible because it was right in the middle of – right as the pandemic was hitting, and that was a tough time to introduce a new product. So I do feel that Apple is going to have a healthy future and will do well.

We do not have plans for another flavor in the near future. I'll never say never. But we're going to focus on these more premium line extensions for now and the core Jack Daniel's Tennessee Whiskey, which is having growth like it hasn't seen in a number of years. We've now – it's going to be several years in a row of growth on growth in ways that we feel pretty good about.

And so, yes, so I think we'll be slow on any flavor extensions, and you're going to see more advertising behind the Bonded series. It's already, we're already promoting it, not price promoting it, but television and digital and all the different ways that we communicate in a big way on these brands. And so it's kind of exciting to see that there's a nice market for some premium extensions off the Jack Daniel's brand.

Leanne Cunningham

And then the only thing that I would build on to that is, when we think about premium extension for Jack Daniel's Tennessee Whiskey, Gentleman Jack is now over 750,000 cases, and we still believe it's very early in its international growth opportunity. So for me, I would say, higher than 750,000 cases.

Lawson Whiting

Yes. I mean, keep in mind, Gentleman Jack, too, was – I mean, as we look back, if we fast forward a couple of years and then look back over everything that happened over this glass shortage, Gentleman Jack is probably going to be the brand that – I don't know if it suffered the most, but it was rough.

I mean, the Nielsen numbers are nowhere indicative of what we think the true underlying demand is for Gentleman Jack. It's just – the brand has just taken it on the chin last year as it really didn't have any supply.

Operator

— ***Operator Instructions*** — And our next question comes from the line of Stephen Powers with Deutsche Bank.

Stephen Robert Powers

I had two questions. The first one is on the U.S. If I back out the trade inventory dynamics and get to the metric formerly known as underlying growth, I think we end up with like a 2% growth number in the U.S. in the quarter, which was a bit light of our expectations. I just wanted to get your sense for how – what that signifies for – because it was sort of that underlying normalized demand in the U.S. if it was in line with your expectations and how you expect it to trend from here?

Lawson Whiting

Well, first of all, calling underlying – what did you say formerly known as? That is one of the better lines I've heard in a while. Look, the U.S. business – our international business is still very much dominated by Jack Daniel's. And so the international demand was very, very strong, and we were able to supply it. The U.S. is much more diversified. And so brands like Woodford and Old Forester, and basically everything other than Jack Daniel's, you've got such a massive, you've got a very broad portfolio that was constrained by glass supply.

I also think, something that – I'm just not sure I appreciated a year ago, but the U.S. on-premise opened up quicker than the rest of the world. And so we're lapping now that reopening. Q1 would have been a heavy reopening period for the U.S. The international markets were more like Q2 or into Q3. And so some of it was just the comps, too. So once again, the answer to everything is glass supply and tough comps impacted the U.S. business.

Look, I look at our U.S. business, I mean, Woodford, I don't know what the U.S. number, I guess it was a global number, but still being at plus 39% is a huge growth number. We've got to get our tequilas going again. I mean, that certainly was not a – that was a negative for the quarter. But still, still feeling pretty good about our U.S. business and the way it has trended over the last – even over the last few years. Our U.S. business has been elevated now really throughout the pandemic.

If you go back and step back a little bit and look over a longer time period, do a 3-year CAGR or a 4-year CAGR, you're going to see our U.S. business has been growing more like – it's been pretty steady, but it's been higher than our historical average. It's more like a 7 as opposed to a really long-term average more like 5 or 6. So U.S. business is still really healthy.

Stephen Robert Powers

Okay. Okay. Yes, that's good perspective. And I guess, the second question, if I could, was just going back to I think it was Andrea's question at the start around inventory dynamics in the second quarter. I may have misheard or misinterpreted the answer, but it seemed like there was a bit more uncertainty from your answer in terms of whether or not and to what degree that trade inventory rebuilding would be a continued tailwind in the second quarter.

I guess, my perspective is, given what we've seen in the first quarter and acknowledging constraints, but seemingly improved supply and just what you're lapping last year with sort of teeth of the supply constraints. I would have expected more kind of affirmative answer that inventory dynamics would be more of a definitive tailwind in the second quarter. And I just wanted to play that back to you and see if I was wrong or if I misinterpreted what you had said earlier.

Leanne Cunningham

Yes. I mean, it comes back to – we're continuing to evaluate the timeline for the normalization of our distributor inventory because we've got multiple factors at play at the same time. Our glass supply position is strengthening. Our facilities are bottling at record paces. We're getting finished cases produced that are seeing challenges to get to market through supply chain, but we have multiple strategies in place to get the cases there.

We are experiencing very strong consumer demand. So as we believe we have inventory to meet demand, demand is increasing. And at the same time, we are launching our new innovation of the Bonded series and getting that to market.

So we know when we started really January, but the second half of F '22, we began producing at a higher level and moving cases into the market. That is continuing, but the rebuild is potentially going to take a longer period of time depending on how consumer demand changes.

Stephen Robert Powers

Yes, it does. So to the extent that you're having – the organic growth will either benefit from – you've got your supply getting stronger. I think you were strengthening. So if consumer demand is strong, that will show up in sort of that show up in consumption. And if demand is a little bit softer allowing you to replenish inventory would show up in kind of the trade inventory build either way – okay, I understand. I'll stop rambling.

Operator

— *Operator Instructions* — And the next question comes from Noah Erni with Jefferies.

Kevin Grundy

It's actually Kevin Grundy here. Congrats on the strong result. I know we covered a lot of ground. Hopefully, these will be fairly quick. Leanne, on FX, I fully acknowledge that you guys do not guide. My question is on transactional FX. So maybe you can just help us think about that. We can do our own modeling on top line. Just thinking about the flowthrough to operating profit, should we be thinking about the same transactional impact to operating income? And that is to say it was a 6% impact, a headwind in the top line in the quarter, it was a 16% impact to profit, so more than 2.5x sort of multiplier, if you will. Is that the right way to think about the impact of profit for the year? Is that something you can comment on?

Leanne Cunningham

Well, as we would think about this, so starting with – it is the transactional impact largely related to the euro and the lira. You're exactly right on the impact. For the shape of it for the full year, I don't want to comment on that because, again, we started in calendar year '23, which again would have hit some of the back half of our F '22. We started to see some challenges with our headwinds from FX. So that will – we'll be going against that a bit in late F '23. But again, it's transactional. We don't see any meaningful remeasurement from a translational perspective. And we've just been clear to say that if we were to assume the rates remain where they are today, it's going to be a headwind.

So I would hesitate to say shape-wise. It will be consistent throughout the year. It will be more consistent than not. It's going to depend when we get into the back half of the year, how we're lapping that.

Kevin Grundy

Okay. Okay. And then a quick one. We've talked about this on the call before. Just balance sheet and uses of cash. So the debt leverage continues to creep lower. Leanne, you talked about some asset sales at the end of your prepared remarks. I'm not sure of magnitude of that, maybe you can comment on how we should think about it.

But just, it'd be good to get your updated thoughts on where your debt leverage is now, even taking into account elevated levels of CapEx for the year. Your debt leverage would still continue to creep lower. So I just – I'd love to get your thoughts on targeted debt leverage. And then as we think about uses of excess cash, where is the bias today between buybacks versus perhaps onetime dividends, of course, there's a long history of Brown-Forman of those sort of considerations. So your updated thoughts there, Leanne, would be appreciated.

Leanne Cunningham

Okay. Great. I'll start with the divestiture of our 2 state mills. Again, this is about optimizing our strategic sourcing model. We think there's going to be – this gives us a broader base of sourcing, continuous improvement initiatives that will ultimately result in cost savings with the economies of scale.

Now the impact of that from a capital perspective, it would not be material. But we do, from a barrel cost, wood cost perspective, we do expect to start seeing favorable cost at the back end of this kind of Q4 of this year. But with our aging process and the associated accounting for that, it will take a period of time before we recognize that. So that – I just wanted to comment on that part first.

And as it related to capital, again, we don't typically – we don't talk about a target. But what is really important for us is that we maintain flexibility and the strength of our balance sheet. We know that we are facing supply chain challenges. There are geopolitical environmental events that we also want to hedge against. So we also want to be well-positioned to take advantage of any potential investment opportunities. So we keep our balance sheet in a place where we could capture those opportunities and hedge against any of the risks.

Lawson Whiting

Yes, I don't think there's much of a change really in our capital allocation strategy. I mean, we're always going to look to invest in our business first. Acquisitions are difficult in this industry, but we're always looking. Share buybacks, the current administration has made them maybe a little bit less attractive with some of the excise taxes that they're posting, but we'll always balance the share buyback and special dividend question.

It's only been, what has it been, 8 or 9 months since we did a special dividend. And so there's not pressure necessarily to do one of those really soon. But I think just at the end of the day, we feel like we're good and smart and we have a good capital allocation strategy, and we're really not changing it.

Operator

Thank you. At this time, we've run out of time for questions. I'd like to hand the conference back over to Sue Perram for any closing comments.

Susanne Perram

Thank you. And thank you to Lawson and Leanne, and thank you to everyone for joining us today for Brown-Forman's First Quarter Fiscal Year 2023 Earnings Call. If you have any additional questions, please contact us. We look forward to presenting next week in person at the Barclays Global Consumer Staples Conference, and hope to see many of you. For those of you that are unable to attend, the presentation will be made available as a webcast that will be accessible via our Brown-Forman corporate website under the section titled Investors, Events and Presentations.

We wish everyone an enjoyable weekend, and hope you will join us in raising a glass on September 2 as we say happy birthday to our founder, George Garvin Brown. With that, this concludes our call.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect. Everyone, have a wonderful day.