

Brown-Forman Corporation, Q3 2022, Earnings Call

2022-03-03

Presentation

Operator

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

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 Third Quarter and Year-to-Date 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 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 third quarter and 9 months ended January 31, 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. As of the third quarter of fiscal 2022, we have changed certain non-GAAP financial measures that we have used historically in our public disclosures, in our analysis of results of operations, in our SEC filings as well as in our earnings release documents. We will no longer report underlying measures of change for any P&L line items. Instead, we will begin reporting organic measures of change for certain P&L line items. This change to our non-GAAP financial measures is in response to comments from and discussions with the staff of the Securities and Exchange Commission. Organic includes all of the non-GAAP adjustments that we have historically made in adjusting GAAP to underlying results except that organic does not include an adjustment for estimated net change in distributor inventories.

We will continue to adjust for acquisitions and divestitures, foreign exchange and unusual or nonrecurring transactions. For comparability purposes, the presentation and amounts of our non-GAAP financial measures for all prior periods presented in today's release and presentation and discussed on today's call have been restated to reflect these changes to our non-GAAP financial measures. We have posted schedules covering historical periods on our website.

Our business can be affected by changes in distributor inventories, particularly in our largest market, the United States, where the 3-tier system includes suppliers, distributors and retailers. We will not adjust our non-GAAP P&L measures for estimated fluctuations in distributor inventories. Yet, we will continue to provide meaningful qualitative and

quantitative information so that you can understand how estimated fluctuations in distributor inventories may affect our results from operations. We have added Schedule E to our earnings release, which contains supplemental information that presents separately the estimated net effect of distributor inventory changes on our results.

In addition to explaining our results, when we expect that fluctuations in distributor inventories could impact our trend significantly in future periods, we plan to disclose that to you as we have endeavored to do previously. Specifically to our outlook, in the past, when we have provided guidance, whether in qualitative or quantitative terms, we have communicated our expectations for key measures on an underlying basis. Going forward, when we provide such guidance, we will do so on an organic basis. Therefore, the current outlook is not directly comparable to our previously presented outlook. Accordingly, we have provided our updated fiscal 2022 outlook in our third quarter earnings release and Form 10-Q using the organic basis. With that, I would like to turn the call over to Lawson.

Lawson E. Whiting

Well, thank you, Sue, and good morning, everyone. I'm proud to share our results with you today as we delivered double-digit organic top and bottom line growth for the first 9 months of our fiscal year. But before I do, I did want to take a moment to acknowledge that the entire Brown-Forman community is extending our thoughts to those impacted by the war in Ukraine, particularly our employees and their families. We will continue to hope for a peaceful resolution. I also want to thank our 4,700 Brown-Forman employees around the globe, many of whom have stepped up to help their Ukrainian colleagues just as they've stepped up in every way the last 2 years. They've made it possible for us to deliver these strong business results.

We have an immensely talented team that remains committed to our strategic priorities and our company values, and it is this resolve and determination that has allowed us to navigate

numerous uncertainties and challenges over the years while delivering sustainable and consistent long-term growth. So turning to the results. We continue to see strong broad-based top line growth across our major geographic clusters driven by many of the same themes that we've shared with you throughout this fiscal year. First, our top line growth accelerated in the third quarter due to the gradual reopening of the on-premise channel, the return of some travel and tourism and the cycling of lower comparisons, notably in emerging markets in the travel retail channel. Second, we continue to see strong consumer demand in both the American whiskey and tequila categories where our brands are well positioned. Our portfolio is also continuing to benefit from the premiumization trends across our industry. Finally, we continue to face challenges from supply chain disruptions largely related to glass supply. These disruptions reduced our finished goods inventories, along with the inventories of both the distributor and retailer levels.

While we are seeing some signs of improvement, the supply chain challenges negatively impacted our net sales and increased our costs in the year-to-date performance. Leanne will talk more about this in just a couple of minutes. These drivers led to an overall reported net sales increase of 11% year-to-date and 14% on an organic basis despite the supply chain problems negatively impacting our results. This was led by a double-digit organic net sales increase for the Jack Daniel's family of brands, fueled by a 20% organic net sales increase for Jack Daniel's Tennessee Whiskey. As a reminder, last quarter, we shared that we had prioritized Jack Daniel's Tennessee Whiskey as we navigated the supply chain challenges. You can see that prioritization in the results as they demonstrate the strong consumer demand for the brand particularly in the on-premise as well as our focus on rebuilding inventories across the supply chain.

Given the size of the brand, this growth is particularly impressive, adding almost 1.6 million 9-liter cases compared to the same period last year. The strength of the Jack Daniel's trademark extends to the full family of brands. Year-to-date, Jack Daniel's RTDs grew organic net sales mid-single digits even against strong double-digit comparisons in the prior year. The consumer

trends of flavor and convenience are continuing to drive demand for RTDs as well as flavored whiskey globally. Collectively, the Jack Daniel's flavors delivered double-digit organic net sales growth year-to-date. The continued international launch of Jack Daniel's Tennessee Apple along with solid volume growth in the United States delivered double-digit organic net sales for the brand. And while Jack Daniel's Honey and Jack Daniel's Fire grew organic net sales year-to-date, both brands' growth rates have been adversely impacted by the supply chain disruptions, which includes our decision to prioritize Jack Daniel's Tennessee Whiskey. The same supply chain challenges had a significant impact on Gentleman Jack, which led to a year-to-date decline in organic net sales for the Jack Daniel's super-premium brands.

The tequila category remains very strong, benefiting our full strength tequilas year-to-date, Herradura and el Jimador grew organic net sales 29% and 20%, respectively, Woodford Reserve's organic net sales grew high single digits year-to-date. But given the prioritization of Jack Daniel's Tennessee Whiskey, the brand experienced a decline in distributor inventories adversely impacting its results. Importantly, we believe consumer momentum for Woodford Reserve remains strong. And similar to Jack Daniel's Tennessee Whiskey should benefit from increased supply as we work through and resolve the supply chain disruptions.

Finally, as I mentioned, our portfolio of super premium brands continues to benefit from the consumer premiumization trends as well as our investment behind our emerging brands teams. Brands such as Old Forester, Chambord, our Single Malt Scotches, GlenDronach, BenRiach and Glenglassaugh as well as Fords Gin have also benefited from the reopening of the on-premise, particularly in the U.S. where this channel is an important part of our brand-building model.

In Europe, the recent investment in our emerging brands model has enabled us to increase our footprint for the Woodford Reserve family of brands, Chambord, our Single Malt Scotches as well as our tequilas. With dedicated teams focused on these brands, we're able to deliver

very strong growth and believe there is considerable opportunity for continued international expansion and growth.

As I close, I want to reiterate my continued confidence in our people, our brands and our strategic priorities. We believe we are uniquely and strategically positioned to capitalize on consumers' preference for premium and super premium spirits, their appreciation for American whiskey and tequila and the continued desire for convenience. This has created strong demand for our portfolio of brands around the world and a healthy runway for future growth as we continue to invest behind these brands. These strengths are the foundation for our continued strong business results even amongst continued headwinds in the form of tariffs, high input costs and supply chain disruptions.

And thankfully, I still continue to believe that many of these headwinds we have experienced over the past few years are soon to become tailwinds. One last topic before I hand it over to Leanne. Yesterday, you should have seen our announcement regarding several changes to my executive leadership team. I'd like to take this opportunity to thank Ralph de Chabert and John Hayes who are retiring later this summer for their many leadership contributions over decades and the many ways, they've helped our company grow and our inclusive culture thrive.

In addition to these retirements, I'm making further changes to my team through disciplined succession planning to continue the company's successful brand building and growth strategies. I'm extremely grateful for the opportunity to work with an executive leadership team composed of such experienced and talented leaders, and I'm confident Brown-Forman is in capable hands under their leadership. Leanne, I'll now turn things over to you.

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. As Lawson reviewed the key themes for the first 9 months of our fiscal year as well as the performance of our brands. I will provide

additional details on our geographic performance, business results and our outlook for fiscal 2022. First, from a geographic perspective. Emerging markets, developed international markets, the U.S. and the travel retail channel all contributed significantly to our organic net sales growth. Collectively, emerging markets, while impacted by supply chain challenges, delivered strong double-digit organic net sales growth year-to-date against favorable prior year comparisons. This performance was driven by the growth of Jack Daniel's Tennessee Whiskey in Turkey and Chile and continued launch of Jack Daniel's Tennessee Apple, most notably in Brazil and Chile. And collectively, our full strength tequila brands grew double digits in Mexico as the premiumization trend continued which more than offset the prior year comparison of New Mix RTDs.

Our overall business in Mexico continues to perform well as we are experiencing a faster-than-expected recovery in the on-trade. Our market share trends are improving, and the pricing environment is positive as suppliers are implementing price increases across the spirits industry. Developed international markets collectively also delivered strong organic net sales growth, up double digits year-to-date. Growth was broad-based, largely due to the reopening of the on-premise as well as a rebound of travel and tourism in some markets. Supply chain challenges impacted our business in countries such as the United Kingdom and France. The Jack Daniel's family of brands continued to drive overall growth as Jack Daniel's Tennessee Whiskey delivered strong double-digit organic net sales growth, led by markets such as Germany, where we are gaining market share and Spain, which is benefiting from the gradual return of tourism.

The United Kingdom in only its second year of owned distribution experienced strong growth despite being impacted by supply chain challenges, while Korea is benefiting from a shift in whiskey consumption to international brands. Jack Daniel's RTDs also delivered double-digit organic sales growth as we continue to experience strong volume growth in Germany, where the brand sustained its momentum and remains a category leader. And even with Australia lapping strong prior year comparisons, it continues to contribute to our growth. In addition,

Jack Daniel's Tennessee Honey grew organic net sales by double digits, led by Korea's shift to international whiskey brands, strong consumer demand in France and tourism returning in Czechia. And while collectively the Jack Daniel's Super Premium brands, which includes Gentleman Jack and Jack Daniel's Single Barrel grew organic net sales mid-single digits as they were significantly impacted by supply chain disruption.

Beyond the Jack Daniel's family, the rest of our portfolio delivered very strong double-digit organic net sales growth led by el Jimador, Chambord and Woodford Reserve, particularly in the United Kingdom, where we have placed additional focus on these brands through our emerging brands group. The U.S. business delivered high single-digit organic net sales growth in the first 9 months of the fiscal year. The largest contributor to growth was Jack Daniel's Tennessee Whiskey driven by volume growth with the continued reopening of the on-premise channel, which led to favorable channel mix. In addition, distributor inventories increased as we work to resolve supply chain challenges. Our tequila brands, led by Herradura also contributed to the strong growth as the tequila category continues to be among the fastest-growing spirits categories, driven by premiumization.

Consumer premiumization trends also continued to benefit our premium bourbons led by Woodford Reserve and Old Forester, yet their growth rates have been significantly impacted by supply chain disruptions, particularly for Woodford Reserve. These disruptions reduced our finished goods inventory along with the inventories of our distributors and retailers. Jack Daniel's Tennessee Honey and Gentleman Jack were also negatively impacted by the supply chain challenges which led to lower year-to-date volumes for these brands. We continue to monitor consumer mobility trends observed by Google Mobility and OpenTable and they showed a decline in consumer activity during the third quarter, reflecting the disruption from the Omicron variant, but trends appear to be rebounding in the recent weeks. In the e-premise channel, our market share continues to remain slightly above 2% and well above pre-pandemic levels even as the on-premise channel reopens and consumers begin to return to in-store shopping.

Finally, our Travel Retail business continued to experience a strong rebound, driven by an increase in volume as we cycled against significant declines experienced during this period last year. Our Travel Retail business is still in recovery as it is dependent on international airline travel and the cruise business, which continue to be below their pre-pandemic levels.

Moving on to gross profit and gross margin. Year-to-date reported gross profit increased 11% with organic growth of 14%, in line with our organic top line growth. Reported gross margin was down 20 basis points year-over-year, driven primarily by unfavorable cost mix and the negative effect of foreign exchange, largely offset by favorable price mix and the impact of the sale of Canadian Mist, Early Times and Collingwood brands in the prior fiscal year. Positive price/mix was driven by favorable portfolio and channel mix. Our portfolio mix has shifted to our higher-margin full-strength spirits brands, especially as we compare to the year ago period when we experienced the very strong growth of our RTDs. In addition, the reopening of the on-premise channel continues to have a positive impact on our channel mix.

Consistent with our comments over the last 2 quarters, our cost increases have been driven by our efforts to minimize the impact of the supply chain disruptions largely related to the glass supply constraints as well as input cost headwinds related to agave and other commodity prices, namely grain. Through close partnerships with our glass suppliers, supply constraints have continued to ease, allowing for some improvement in inventory levels in the U.S., particularly for Jack Daniel's Tennessee Whiskey. Inventory levels do remain below the prior year at both the distributor and retailer levels. Agave costs are remaining stable but are higher than our expectations as they are not easing as quickly as we thought due to the increased demand for our tequila brands as growth in the U.S. and a faster-than-expected rebound in Mexico continued.

Turning to our operating expenses, which represents the investments we make behind our people and our brands to drive sustainable long-term top line growth. Our reported and organic advertising expense increased 12% year-to-date as we continue to invest behind our brands. In the third quarter, reported advertising expense decreased 4%, down 2% on an organic basis as we now cycle the phasing of spend from the first half to the second half of last fiscal year. SG&A expenses on a reported and organic year-to-date basis increased 8%, led by compensation-related expenses. Our operating income on a reported basis decreased 4% primarily driven by the effect of the prior year sale of Early Times, Canadian Mist and Collingwood brands. On an organic basis, operating income grew 19% year-to-date. The decrease in reported operating income combined with a year-over-year increase in our effective tax rate resulted in a 12% decrease in diluted earnings per share to \$1.43 per share.

Now to our updated fiscal 2022 outlook. As Sue mentioned in our opening comments, when referring to certain non-GAAP financial measures, we will no longer report underlying measures of change for any P&L line item and will report organic measures of change. Therefore, this current outlook is presented on an organic basis and is not directly comparable to our previously presented outlook. With that, the operating environment does remain challenging, and there are a number of uncertainties related to the pandemic, supply chain, inflation and the geopolitical environment. Amid these uncertainties, we continue to be confident in the strength of our portfolio of brands and our team's ability to navigate these challenges. Therefore, we are optimistic in our ability to deliver strong full year results.

With our strong year-to-date performance and consumer demand for our brands, we expect organic net sales growth of 11% to 13% for the full fiscal year. This is based on the continuing strength of our U.S. business, even as we cycle the prior year reopening of the on-premise, the continued benefit from the reopening of the on-premise channel and the gradual recovery in travel and tourism in our developed international markets, strong growth in our emerging markets as well as Travel Retail as the recovery gains momentum, and we cycle the effects of easier comparisons. And we continue to expect our noncore business, mainly used barrel sales

do not have a material impact on our results this fiscal year. We also believe that our supply chain constraints will continue to ease, enabling us to meet consumer demand as well as rebuild inventory levels across our supply chain. Additionally, we believe our portfolio of brands is well positioned to continue to benefit from premiumization trends as well as the price increases on a number of our brands in the U.S., including Jack Daniel's.

We are beginning to see pricing reflected in the U.S. data. And while food and beverage as well as the spirits inflation lags the overall CPI, the numbers still show a healthy pricing environment. Based on Nielsen takeaway data through the end of our third fiscal quarter, Brown-Forman is outpacing TDS pricing growth and is a pricing leader.

Turning to gross margin. We continue to utilize our risk mitigation strategies to manage through the impact of supply chain disruptions and are addressing the various constraints on our business. We still believe that these challenges will continue to improve as we end the fiscal year, though still a headwind on a full year basis. We project cost headwinds related to logistics as well as agave and other commodity prices, mainly grain, will continue to have a negative impact on our gross margin. As we shared last quarter, these headwinds will be slightly offset by the modest positive impact from the removal of tariffs in the EU, which ended on January 1, 2022. Based on these combined headwinds and tailwinds, we continue to expect reported gross margin to be flat or slightly down for the full year compared to fiscal 2021.

Before I move on, I wanted to provide a quick update regarding the U.K. whiskey tariffs. While the EU tariffs have been removed, the U.K. tariffs remain in place. Talks are still ongoing between the U.S. and the U.K. regarding the tariffs that remain in place, and we continue to be cautiously optimistic that both parties will resolve this ongoing trade dispute. We expect our total organic operating expenses, which include advertising and SG&A expenses to be in the 7% to 9% range as we continue to invest behind our brands to support our ability to gain share and to drive top line growth.

On an organic basis, we anticipate advertising expense to be slightly below top line growth. The growth in SG&A has been focused on increasing the level of control we have in our route to consumers, 2 of which Belgium and Taiwan have already launched this year. We have also invested in the international expansion of our emerging brands team and increased investment in our digital marketing and e-commerce capabilities. These strategic initiatives support the growth and development of our broader portfolio of brands. Based on the above expectations, we believe our organic operating income growth will be in the range of 12% to 16% for the full year. Lastly, we continue to expect our fiscal 2022 effective tax rate to be in the range of about 22% to 23%.

In summary, we are pleased with our strong year-to-date results, which delivered double-digit organic top and bottom line growth. Over these past 9 months, we have continued to build momentum in a challenging and evolving operating environment and believe we are well positioned to have a strong fiscal 2022 because of the strength of our team members and our portfolio of brands. Our team has remained agile and resilient while living our company's values. And our portfolio of brands has remained strong, supported by our strategic priorities, our investments and consumer trends. We will continue to care for our people and our brands as they are the pillars of our ability to deliver sustainable long-term growth. This concludes our prepared remarks. Please open the line for questions.

Question and Answer

Operator

Our first question comes from Vivien Azer with Cowen.

Vivien Nicole Azer

So I've got a modeling question and then just a follow-up on Woodford, please. So on the model, I am having a really hard time understanding what happened with currencies this quarter, 6% on the top line versus 18% on OI. I would have thought that you would have seen more on gross profit given the transaction impacts, but the GP hit was only an 8. So if you can offer any color on why the FX impact was such a greater magnitude on the OI line in the quarter, that would be really helpful.

Leanne Cunningham

Well, we know, Vivien, that the strongest drivers of that is the strengthening of the U.S. dollar. And then against that, the currencies would have been the largest impact was in Turkey, then we also had an impact with Russia and the U.K. So those were the largest drivers. And you can see that in the schedule that in the press release where it says rest of, that's where you'll see the biggest impact. Yes, I believe that's Schedule C for you.

Vivien Nicole Azer

Yes, but is it just an outsized translation impact, just kind of a timing of recognition in the quarter?

Leanne Cunningham

From translation.

Vivien Nicole Azer

It's translation. Okay. Very good. I can certainly follow up after that. On Woodford, totally understand the reprioritization of the glass supply, and it looks like that strategy is playing out quite nicely given the reacceleration that you're seeing on the Jack Daniel's franchise and Jack Daniel's Tennessee Whiskey, in particular. But I was curious if you could comment, please, on the sequential degradation that you saw on price mix for Woodford in particular.

Lawson E. Whiting

Okay. Sure, Vivien. And I'm going to walk you all through kind of the long story as to what has happened between the quarters on the rest of the portfolio and Jack, just so everyone understands it because I do realize it is very complicated and kind of hard to follow. Let me say something about Ukraine and Russia first, just to get it -- not to get it out of the way, but know that it's hard to talk business these days when so much of this is hanging over. So just a couple of things. One, no, obviously, we are most concerned with our people that are over there. We do know they're all safe right now, but it is certainly a very, very difficult and volatile situation. It's scary. It's sad.

It's exhausting for the employees and we're trying to do what we can from here. We're committing financial assistance not only to our employees, but to some of the big organizations that are trying to help out. And just a little story that I found, I don't know, touching, I guess, a little bit in that our employees that live in Poland and Romania and Hungary have a number of them, they go to the borders and our employees that have been trying to leave Ukraine. And thankfully, they were -- they got ahead of what -- masses over there and met at the fences literally, and our employees picked them up and took them to their houses and are taking care of them now.

So there are some touching stories out there and our thoughts are with all of them. The other part of this that I might as well get out of the way now is just on the business side of things, it does feel awkward to talk about the business in Ukraine is obviously shut down. But in Russia, we want to make sure that people don't overestimate the size of our Russian business. It's a top 10 market. I mean it's 10th or it was 10th in fiscal '21. And we disclosed last year, it was 1% of our business worldwide.

So important, it's been a growing market for us, which -- that's obviously going to be greatly disrupted. But as I think you all would know are those that have been following us closely,

we've been building to have our own route-to-market organization there. We've got about 80-some-odd employees now. We were hiring a lot more than that with the intent to go live in July. We've stalled that or paused it. We've paused on the recruiting there. And at this point, we're just waiting to see. We're going to have to evaluate the situation. It's only been a week. So we don't really have a lot more information to share on it right now, but know that we're doing everything we can. So get that out of the way, and then I'll answer your other question really speaks to Woodford and it's more than Woodford, it is essentially all of our core brands outside of Jack Daniel's Tennessee Whiskey.

So to set the stage, remember in fiscal '21, Jack Daniel's Tennessee Whiskey was down 4% as its on-premise business was so weak. But Brown-Forman Corp did a plus 6, which the only way that math works for us is you saw very, very dynamic growth in brands like Woodford, Old Forester, tequilas, namely, the Jack Daniel's flavors everything was -- practically everything was in double-digit growth mode last year. So it was an unusual year, but it worked out that the company was still able to deliver a 6% growth in a chaotic year.

Now moving forward a little bit. Q1, we talked for the first time in Q1, which is August of last year, we started talking about allocating glass to Jack Daniel's. The on-premise was opening around the world, and we did not want to miss that opportunity and so that was the prioritization. Yes, in the 9 months, Jack Daniel's Tennessee Whiskey organic growth is plus 20. I mean those are numbers that I have never seen in my career, and it's driven by the strength of the on-premise and global travel retail, but it's still -- it's also the off-premise too. So it's a global drive to drive that brand up. And it's an incremental 1.6 million cases in the first 9 months of the year. 1.6 million cases is bigger than most of the brands in our portfolio, and that's the incremental in 9 months. So -- and Jack Tennessee Whiskey is above TDS in the United States just by a little bit. But quite honestly, Jack -- The Black Label has not been above TDS given its size in a long time. So it just, I think, shows that when the stock is available, when the glass is available, there's still tremendous amount of consumer demand for the brand, and that makes us feel good.

Now moving forward, in the fall, as we had allocated towards Tennessee Whiskey, we really -- the rest of the portfolio began to slow. And in the fall, we were able to draw down on inventories for a while. But that's -- we ran through the inventory, say, September, October, November time frame, it became a bigger and bigger problem. And so if anyone is looking at the takeaway data, the Nielsen takeaway data, which is very weak on that rest of the portfolio is directly because of the Christmas season for a lot of those brands, we were out of stock and it was painful. It was something the entire organization was going through, and it showed up in the U.S. most directly because the U.S. has the broader market, the broadest set of brands in the market. So that was a tough cycle to get through. But now fast forwarding to the last quarter and you can see on Schedule E in our earnings about how we are now rebuilding those inventories. And shipments are running ahead of depletions which is a good thing.

I mean we're finally getting the glass to be able to reload the minute that stuff gets in -- this is mostly a U.S. conversation. When it gets into the warehouse, it is very quickly out the door and back on retail shelves. And we believe that the trends will resume. So Woodford Reserve was growing at 20% a year plus for 20 years. There is no sense that, that brand is going to lose consumer momentum. It's just got to be available. And so it's getting onto the shelves now. It will take us several more quarters we think to fully reload, we'll see. But it's not that data or that takeaway is not reflected in the current set of -- I said that wrong. The takeaway is not reflected yet in the Nielsen figures. We believe it will shortly. But that is the reason why it looks like it had lost so much momentum. So -- that's the long answer to a short question, but that is -- I hope you understand the sort of at least what has happened.

Vivien Nicole Azer

And I'll certainly echo our sincere thoughts and prayers for your team in the region.

Operator

Our next question comes from Nadine Sarwat with Bernstein.

Nadine Sarwat

I want to focus on the advertising expense. So I appreciate the comp impact. But by my calculation on a 9-month basis, your reporting advertising margin was about 10.6%, below last year, 11.5% and below the F '14 peak of 14.6%. So is there a technical reason behind this being lower? And what should we expect for normal advertising spend going forward?

Leanne Cunningham

Thank you, Nadine. It's nice to have you on the call. From a brand expense perspective, it really is a story of prior year because as we entered into our first fiscal -- full fiscal year '21, we didn't know what the operating environment was going to be. Events were closed and not available to us as well as sponsorship. So we had lighter spending in the first half of fiscal '21. And we were more heavily weighted to the back end of the year. For fiscal '22, we are much more spending along our normal phasing cycle. It's just going against an unusual prior year. And then as you think about it, previously, as we had talked about, our brand spend being in line with our top line growth, as we have moved to an organic basis, our brand spend, we believe, for the quarters ahead will be slightly below our top line growth.

Lawson E. Whiting

But still very healthy. I mean we're still -- what is it year-to-date?

Leanne Cunningham

Our full year increase is in the 7% to 9% range, and that includes both our strategic initiatives we're investing and our brand expense.

Nadine Sarwat

Got it. And if I could just squeeze one more. The price mix of 70 bps contribution to the 9-month gross margin change in the presentation was a really good notable improvement on the 10 bps drag that we saw at H1. Can you give us a sense of how that's split between price and mix? And then I'll hand it over.

Leanne Cunningham

So it's more volume driven, but it's related to, as we said in our prepared remarks, the reopening of the on-premise from a positive channel mix perspective. And then also from our portfolio mix, which we are more skewed in this fiscal year towards our full strength spirits, particularly Jack Daniel's Tennessee Whiskey. And last year, we just had the strong growth in RTDs that we're now cycling. So it makes a positive portfolio mix.

Operator

Our next question comes from Nik Modi with RBC Capital Markets.

Sunil Harshad Modi

Just a couple of questions. We've been hearing in the trade that maybe some of your competitors might not be doing as well on the glass supply situation. So I wanted to see if that was something that you have seen in the market and do you think that contributed or how you're benefiting from that at retail? And then the second question is, again, more lately, inflation obviously has not been great for the consumer. We are hearing of some consumer shock, I guess, with some of the pricing that's in the marketplace. So I was just curious on if you had any commentary on that or you're seeing that in the market as well.

Leanne Cunningham

Well, I'll start specifically with our glass supply, and we've been talking about this for several quarters now. For Brown-Forman, that was our largest driver of supply chain disruptions. And we've just continued to work really closely with our current supplier, which has yielded an

improved glass supply and additional capacity. We've been also expanding our glass supply network, and we believe that, that work will start increasing and supplementing our current supply in the fourth quarter of this year. And as Lawson mentioned, as that glass is coming in, we are producing it as quickly as possible.

But with the multiple months that we had to draw down our finished goods inventory at all levels of the distribution channel, the supply chain, it is moving through the supply chain incredibly quickly, and we are still working to rebuild our inventories. To date, it has been some. We believe that it has taken us multiple quarters to get -- to draw down those inventories. It's going to take us multiple quarters to build that back. And we just continue to have teams that are working on prioritizing the most optimal use of those finished cases that we're able to produce.

Now from a competitor perspective, we know others have commented on it, and we'll let them kind of tell their story. So with that, I'll switch over to inflation. And as we talked about with our year-to-date gross margin, we did have 110 basis points related to higher cost. That is split between the supply chain -- the costs associated with our supply chain challenges that we have had in trying to, as quickly as possible, get our finished cases into the consumer's hands. While like others, we're facing increasing commodity costs on corn, grains, natural gases, wood, steel. But the good news is, agave has stabilized. We had hoped that the cost of agave, the price of agave was going to decline more quickly. But as we've reported on multiple quarters now, the increased demand for the tequila category has just maintained that, but at least it has stabilized in that MXN 27 to MXN 29 per kilo range. So we are seeing inflation, but the good news is we've got a lot of things working in our favor, which is premiumization trends. We already mentioned our favorable channel mix. We're fully utilizing our RGM tools, and we've talked about how we're taking price to help with the inflation that we're seeing, not the reason why we're taking it, but it is a positive offset to some of the price increases or some of the cost increases that we're seeing.

Lawson E. Whiting

Yes. I mean I think in terms of inflation, make sure I answer the right question. But I mean the -- there is some spirit -- there is pricing happening in the spirits category right now that is stronger than it has been, I'll say, in the last, I don't know, 5 years or more. If you really try to pick a part in Nielsen figure, then -- and obviously, this is a U.S. comment, the spirits inflation is between 1 and 2 points. And we're going to be there, too, maybe even a little better than that. And I would call that really on a global basis that is -- it's almost been -- I don't know if I quite call it a cultural change, but it has been a mindset change inside the company really over the last year, not just the last quarter, where we are pushing through low single digit but steady price increases, and it's a goal to be able to do that consistently over the upcoming years. And we'll see what the consumer reaction is. I mean the consumer action right now on other inflationary comments. I mean, gas prices going up is generally not great for the spirits industry. It's not great for consumer spending in general. We'll have to see how that plays out. I mean, so much of it is so recent that I don't really have any data to support that. But no, we've pushed through price increases in the U.S. on Woodford, on Old Forester, el Jimador, Herradura, Chambord and really the vast majority of the Jack Daniel's portfolio. So we are following through with what we said to you last quarter and still feeling pretty good about our position.

Sunil Harshad Modi

Excellent. If I could just quickly follow up, Leanne, on the inflation comment. Given the aging process of the product, would it be fair to say that some of the inflation that you're seeing now won't really be an issue for Brown-Forman until we get kind of maybe into 2023 and beyond? Or am I not thinking about that the right way?

Leanne Cunningham

Not to get in too much of the technicalities with the way and the methods that we use, most notably LIFO, most commodity costs will come through as we incur them except for wood. Wood is one that will layer in over time.

Operator

Our next question is from Bonnie Herzog with Goldman Sachs.

Bonnie Lee Herzog

I just wanted to kind of circle back on a few things and just kind of ask about the way you're going to be discussing results now going forward in terms of organic sales growth and then distributor inventories. I understand everything you guys said, but I just was hoping to maybe get a sense of how much distributor inventories may have impacted your results in the quarter? And then given the supply challenges, which you guys have discussed, is there a way for you to quantify how much your top line was negatively impacted in the quarter? I'm just trying to get a sense of maybe how much higher it could have been. And then when you guys are expecting some of these supply chain pressures to ease?

Leanne Cunningham

So I'll start with the change and how we talk about our business. And again, as you would have heard from Sue, this is driven by a comment letter from and discussions with the SEC. And just so that you all are aware, all of that has posted as of yesterday out on EDGAR and available to you. As we think about it, it might be easier to run through an example. So when -- in our earnings release, when you read that the U.S. business on a reported basis grew 5%, organic basis 8%. And then in the commentary, it says an estimated net increase in distributor inventories positively impacted net sales. We added -- we believe that it is important information with the transparency of what the health of our business and the fact that we have added Schedule E. And at the bottom, you can see how then following on the U.S. example that the net change in distributor inventories was 2% for the United States. So our

organic was supported by 2% of net change in distributor inventories. We believe that supplemental information is important to continue to provide transparency into the trends of our business. That chart will give you our geographic and brands. And then at the bottom, you can see that the statement of operations line items that net sales in total was 2% impacted by -- are organic impacted by the net change in distributor inventory. Does that help?

Bonnie Lee Herzog

Definitely. Yes, that does. And then just thinking about all of these puts and takes, and especially kind of going back to the supply chain pressures because if I'm hearing you correctly, like that obviously was an impact in the quarter and I think, year-to-date. So I'm just trying to get a sense of the magnitude and when some of these are expected to maybe normalize as the pressures ease.

Leanne Cunningham

Yes. And then as we -- as I previously stated, it took us several quarters as we were going through the most significant period of glass supply constraints, and we have to draw down distributor and retailer inventories and even inventories at our own facilities. It's going to take us several months to rebuild that. So we do expect for shipments to exceed our depletions as we continue to rebuild that inventory.

Lawson E. Whiting

And a comment on the underlying thing, too, a little bit. We were the only company -- I think this is true that was doing underlying reporting and is why the SEC couldn't get their heads around it. So we switched to organic, which is now largely consistent with the way the rest of the industry has been doing it for a long time. So on a positive side of it all, we're now sort of equivalent with them and make it a little bit easier to compare. But I do recognize that this is a crazy quarter to be doing it given the volatility in distributor inventory.

Operator

Our next question from Kevin Grundy with Jefferies.

Kevin Michael Grundy

Two questions for me, if I may. Just first on the organic sales growth guidance, not asking to repeat what you've said in prior questions. But just specifically with the change in methodology because it would seem like some of the upward revision would be owed to changes in distributor inventory levels. But very specifically, if you can sort of unpack the other items, other areas of the business, which are coming in better than you had expected, I think that would be appreciated. It seems like international business certainly stronger than we had modeled, on-premise recovery, it sounds like strong as you modeled. But maybe on a like-for-like basis, just comment on what came in better in the quarter? And then I have a follow-up.

Lawson E. Whiting

I'll start it at least. I mean what came in better in the quarter was Jack Daniel's Tennessee Whiskey. I mean it was a blowout in terms of its ability to get the glass, get it through the system and the demand, I don't want to say, surprised us to the upside, but it was just very, very strong. And so when that gets going, it's amazing what kind of growth that this company can do. I compared it to last year when it was down 4%, and we were able to do the 6%. I mean that -- it's not going to maintain its 20% growth rate through the year, but it's still going to be outstanding. So -- and it really -- it came from really all parts of the world, really showed pretty dynamic growth. We had some really strong markets in Europe and some very strong markets in the emerging world.

Leanne Cunningham

Yes. And I think that's the big story. The big story is our business has just been very resilient and Jack Daniel's Tennessee Whiskey returning to growth related to the reopening, travel and tourism. Really, we keep seeing strong consumer demand for both our American whiskey and

our tequilas, premiumization to the extent that they weren't disrupted by supply chain challenges. Woodford Reserve, Old Forester, Herradura continue to just exceed expectations. And then again, we have the rebound from the Travel Retail. And all of our -- and we said it in our opening comment, we are seeing growth in all areas of our business geographically, including the global travel retail channel.

So I think that as an underlier, regardless of what methodology or bases change we're using. I think that's the big story. So that would have been a driver regardless of the change. What you can do, again, at the bottom of Schedule E, you can take a look at the organic guidance that we have put out there. And as you try to make some high-level adjustments for net change in distributor inventory, I think you continue to see that compared to our half year, we have momentum.

Kevin Michael Grundy

Got it. That's helpful. If I could just -- one more. I'll take a number of these offline. But just shifting to capital allocation, repurchases and share repurchases specifically. Any updated thoughts there? And maybe just comment on I guess, maybe some of the hesitancy to sort of weigh back in with respect to share buybacks. The cash level is near historic highs, your leverage ratio continues to creep lower and the business is obviously performing really well. And it's obviously still volatile, but we're in a much better place collectively than we were a year or 2 ago. So kind of pulling that all together, what maybe comment on the hesitancy to buy back shares. And I'll pass it on.

Leanne Cunningham

Yes. I don't know if I would call it a hesitancy. I think we always look -- we try to use a very balanced approach because our core objective is for sustainable long-term value creation. And you know we've talked about this many times, all of the dimensions over which we balance that. And we have ongoing investments in our business as far as the Kentucky distilling

expansion, we have had distilling expansion in our tequila facilities. We have our Single Malt Scotch GlenDronach expansion. We have warehouse expansions to support Jack Daniel's growth, family of brands growth and which we reserve and those are -- they cost more in today's environment based off the inflation we talked about.

But our #1 objective is to maintain flexibility and strength of our balance sheet to do a couple of things, which is to be able to invest back behind our business and to take advantage of growth opportunities. And recently, we did just do a special dividend. It's approximately \$480 million. So we did deploy cash to our shareholders from using that method. So again, our approach is consistent, balance, it's about maintaining flexibility. And we are looking at many things to -- from the investments that I just spoke of, and we're also thinking about the increased volatility that might be in the months and times ahead related to the geopolitical environment that are just unknown at this moment.

Operator

Our next question comes from Powers with Deutsche Bank.

Stephen Robert R. Powers

So on the operating income guidance, year-to-date growth is plus 19%. The guide is for 12% to 16%. So it implies 4Qs to be negative. And I just was wondering if you could just unpack the drivers there, especially because you're cycling last year's foundation contribution. I don't know if that's included in the organic base or not. But just how we should think about the OI progression in 4Q. And then I guess on top of that, back to Vivien's question just how we should expect FX impact to trend as it relates to operating income through the remainder of the year?

Leanne Cunningham

Well, I'll start with your last part. We don't forecast FX. We have it in there as what is known to date, but we wouldn't attempt to forecast what that changes going forward. And then as I would just say from an outlook perspective, in our fourth quarter, we really are going to be cycling our strongest comps from the prior year when in the last quarter of the prior year, the on-premise largely -- I mean, in some places around the world, but specifically in the U.S., our largest market began to reopen. So we do know we're going against some tough comps. And we also -- we're still addressing some supply chain constraints and input cost headwinds. And then I'll just layer on the last piece, which is potentially the rising uncertainty of the geopolitical environment and the unknowns which that creates.

Stephen Robert R. Powers

Okay. That's fair. I guess I'm thinking about the organic guidance implies growth, both shipment and probably some inventory catch-up, but then your -- the cost trends are overwhelming that in the implied guide. So is it -- where is the cost pressure coming from? Is it COGS? Is it incremental SG&A? And just how we should think about that?

Leanne Cunningham

So what was -- so from a cost perspective, we've talked about our commodities, we've talked about with labor. We've talked about transportation, which continues to be constrained, freight rates due to logistics imbalances. All those things are in there. And then we also are continuing to invest from an SG&A perspective in our strategic initiatives, which is increasing the control of our distribution, increasing the focus on our super premium brands and places around the world. And then just increasing investments back behind our brands with new marketing campaigns and a new -- what we refer to as an IMC organization.

Lawson E. Whiting

Yes. I mean I think the biggest part of it really is tough comp, though. I mean, I think that there's nothing really unusual going on or anything like that. It's just -- I mean, last year, fourth quarter was plus 19%. Is that right?

Leanne Cunningham

Yes.

Lawson E. Whiting

So going against the plus 19%.

Stephen Robert R. Powers

Okay. And I guess the other -- if I could squeeze in one more question. Just I know it's hard to dimension and certainly hard to time. But as we think about just how far below some kind of normalized inventory levels you are exiting the third quarter. Is there a way to size that? Is that on an annualized basis, maybe a couple of points of revenue growth to catch up to relative normal? Or how do we think about the magnitude of the inventory rebuild that remains?

Leanne Cunningham

Yes. And this is not going to be -- and I've said it a couple of times. And this isn't a specific number, but if for example, it has taken us 3 quarters to draw down that inventory. We do believe that it is going to take us 3 quarters to fully replenish our inventories at all levels of the supply chain. So as we look ahead, we do believe that we're going to see those shipments be stronger as we refill the inventory levels across the retailer, the distributor and our internal.

Operator

Our next question comes from Chris Pitcher with Redburn.

Chris Pitcher

A couple of follow-up questions for me. Firstly, apologies coming back on the Russia situation, you had a very strong organic performance in Russia. Are you shipping and rebuilding inventories with the new route to market in place there? Or are you still selling into independent parties? And in terms of going forward, the inventories there will be enough to carry you forward for how many quarters without the ability to ship in? And then secondly, has the sort of the development in sort of global events perhaps slowed the expansion of route to consumer that you've been putting in place? I think you've got up to 70% of your international business through your own distribution is something that perhaps we might see a pause now for a while until things settle.

Lawson E. Whiting

Well, we're still -- for the time being, we're going to continue using that same, I think called independent third-party distributor. I don't have -- I don't know how many months of inventory they have. But they're continuing to stay in place. And so that -- we don't expect a ton of disruption on at least on that side. Now consumer demand is going to fall off. There's no way. I mean we're all -- and I think the competitors are doing it too, taking big price increases as the ruble has fallen so far. So that's going to shave off some demand. But what was a very strong market for us is going to be less of a driver going forward. But as we said earlier, I mean, it is -- in fiscal '21, it was 1% of our sales. So it's not a falling off the cliff. What's the other question?

Leanne Cunningham

And then the only thing I would add is we aren't in a normal steady state. We are in a situation where we are prioritizing the most optimal usage of our finished goods. So as we think about our business, we will -- I mean, we will deploy that inventory globally in the way that most optimally benefits the company.

Lawson E. Whiting

Meaning higher margin markets are going to get more -- get first choice in the glass line over those that are lower.

Chris Pitcher

And maybe to follow up, had you sunk much in the way of costs yet into Russia? Or are you still at the sort of the design phase? I think you mentioned you started to, but I'm just trying to get a sense of how much sunk cost is there versus variable?

Lawson E. Whiting

Well, I mean we have begun -- or we had begun to hiring. I said a little bit ago, we had 80-some-odd people in the Russian market right now. We're obviously putting a pause on that, and we're just trying to survey. I mean it's only been a week, so we just haven't -- we haven't made any sort of material decisions yet. But there wouldn't -- there's not going to be a write-off or anything like that, that I would expect out of that market, I mean, yes.

Leanne Cunningham

Yes, it's a fluid situation, and we're -- as we meet 3 months from now, we hope that we have much better geopolitical news to report. But at this point, we're just continuing to assess where we are.

Operator

We have run out of the time for Q&A. I would now like to turn the call back over to Sue Perram, Director of Investor Relations, for closing remarks.

Susanne J. Perram

Thank you, Shannon, and thank you to Lawson and Leanne, and thank you to everyone for joining us today for Brown-Forman's Third Quarter and year-to-date fiscal 2022 earnings call. If you have any additional questions, please contact us. And with that, this concludes our call.

Operator

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



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