

Brown-Forman Corporation, Q1 2024, Earnings Call

2023-08-30

Presentation

Operator

Good morning, and welcome to Brown-Forman First Quarter Fiscal Year 2024 Earnings Conference Call. — ***Operator Instructions*** — I would now like to hand the conference over to Sue Perram, Vice President, Investor Relations. Ma'am, you may begin.

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 2024 Earnings Call. Joining me today are Lawson Whiting, President and Chief Executive Officer; and Leanne Cunningham, Executive Vice President and Chief Financial Officer.

This morning's conference call contains forward-looking statements based on our current expectations. Numerous risks and uncertainties may cause actual results to differ materially from those anticipated or projected in these statements. Many of the factors that will determine future results are beyond the company's ability to control or predict. You should not place undue reliance on any forward-looking statements, and except as required by law, the company undertakes no obligation to update any of these statements, whether due to new information, future events or otherwise.

This morning, we issued a press release containing our results for the first quarter fiscal year 2024 in addition to posting presentation materials that Lawson and Leanne will walk through momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations.

In the press release, we have listed a number of the risk factors you should consider

in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K and Form 10-Q reports filed with the Securities and Exchange Commission.

During this call, we will be discussing certain non-GAAP financial measures. These measures are reconciliation to the most directly comparable GAAP financial measures and the reasons management believes they provide useful information to investors regarding the company's financial condition and results of operations, are contained in the press release and investor presentation.

With that, I would like to turn the call over to Lawson.

Lawson Whiting

Thank you, Sue, and good morning, everyone. It's a pleasure to be able to speak to you today about Brown-Forman's first quarter results for fiscal 2024. Before we get into the details of the quarter, there are a few key drivers of our first quarter results that you will hear about repeatedly throughout this call.

First, the rebuilding of distributor inventories, primarily in the United States, in the prior year period had a significant impact on our first quarter results. As you will recall, this rebuilding in the prior year occurred as a result of supply chain disruptions. If you reference Schedule D in today's earnings release, it will provide you with additional information to put this quarter into better context.

Second, the timing and phasing of our operating expenses had an impact on our first quarter operating income as we launched and acquired new brands while also investing in our existing portfolio. As you can surmise from our full year guidance, we expect this to moderate as we continue throughout the rest of the fiscal year. And finally, and most importantly, we believe the health of our brands and our business remain strong as ev-

idenced by consumer takeaway trends. We continue to be confident that we have the best portfolio and the best people in the market, and it's this confidence that allows us to reaffirm our full year outlook for fiscal 2024.

With this backdrop, let me quickly walk you through our high-level results for the first quarter. From a top line perspective, our reported and organic top line results were below our longer-term historical trends. Much of this is being driven by the comparison to the strong double-digit top line growth in the first quarter of last year. You'll recall our glass supply significantly increased in the spring and summer of 2022 which allowed us to rebuild distributor inventories, which created a strong comparison for the first quarter of this fiscal year.

Our gross margin expanded with favorable price mix and the removal of the U.K. tariffs. These gains more than offset increased input costs, foreign exchange headwinds and the impact of our recent acquisitions.

In the first quarter, we also made significant investments behind our brands and our people which resulted in a year-over-year decrease in reported and organic operating income.

Now let's go into each of the P&L items a little bit more. I'll briefly provide a few more details on the top line from a brand perspective, and then I'll turn it over to Leanne who will share additional insights on our geographic performance as well as other financial heights before closing with some comments on our fiscal 2024 outlook.

Our reported net sales growth increased 3% with organic net sales growth increasing 2% after adjusting for the recent acquisitions and the negative effect of foreign exchange. Organic net sales growth in the quarter was driven by the continued growth for Jack Daniel's Tennessee Whiskey, Jack Daniel's Tennessee Apple and El Jimador. This growth was partially offset by declines related to the estimated net decrease in distributor inventories,

particularly for brands such as Woodford Reserve, Jack Daniel's Tennessee Fire and Gentleman Jack as we cycled against the significant inventory rebuild in the first quarter of last year.

In total, we estimate that the net change in distributor inventories had a 6% impact on our overall top line results. If you were to factor in the net change in distributor inventory, our net sales growth would have actually been above our long-term growth expectations. As I mentioned earlier, we believe our business is strong.

Jack Daniel's Tennessee Whiskey led our growth as organic net sales increased 2% after lapping organic net sales increase of 21% in the prior year period. We believe the consumer demand is normalizing and estimate that the growth rate on Jack Daniel's Tennessee Whiskey in the first quarter was lower by approximately 2 percentage points due to the net change in distributor inventory. Growth continues to benefit from our pricing strategy as well as our revenue growth management initiatives.

Second, Jack Daniel's Tennessee Apple grew organic net sales more than 50% as we lap the impact of the glass supply constraints in the year ago period, and we're better able to meet consumer demand, particularly in markets such as Brazil. The brand also benefited from a strong launch in South Korea. Demand for Tequila, particularly in the U.S., remains strong. El Jimador was the third largest contributor to overall company organic growth, increasing organic net sales 26%.

We continue to see strong momentum in our ready-to-drink portfolio, which grew organic net sales 5%. This was led by the launch of Jack Daniel's in Coca-Cola and the continued growth of new mix which performed well as the RTD category in Mexico is growing and the brand is increasing share. The growth was partially offset by planned declines in Jack & Cola as the market's prepared for the Jack Daniel's and Coca-Cola launch. I know there's been tremendous energy and curiosity around our new Jack Daniel's and Coca-Cola RTD.

So I thought I'd share a bit more detail on the continued launch.

Impressively, the global volume has already grown to 1.8 million cases across 11 markets, led by the U.S. and Japan. As we've shared before, some markets are being led by Brown-Forman, whereas others are being led by the Coca-Cola Company. Therefore, this total case volume is not reflected in our 9-liter depletion results.

We expect that this total volume will continue to grow as we plan to expand from 11 to 30 markets by the end of calendar 2024. In the U.S., the Jack Daniels and Coca-Cola RTD launch has been the most successful launch in Brown-Forman history, having achieved the second highest level of off-premise distribution across the portfolio only behind Jack Daniel's Tennessee Whiskey.

Today, it has reached over 2% of the RTD categories value share. And overall, we're pleased with the initial launch of this iconic product and believe our success is driven in part by the strong investment behind the launch including significant investments in broad-reach media, events and trade execution. As the launch evolves, we would naturally expect this investment to normalize.

We're also excited by the brand visibility, the market share gains and the positive feedback from distributors, retailers and most importantly, consumers. I must say, you know you're doing something right when consumers start wearing your spirit brands. And I just saw a picture of the first reported Jack & Coke RTD Tattoo. The loyalty of our Jack Daniel's fans is strong and impressive.

The Jack Daniel's and Coca-Cola RTD has been a strong addition to the portfolio, which as you know we have been very strategically reshaping over the last couple of decades to focus on premium and super premium brands. We continue to believe this premiumization provides us with the best opportunity for long-term growth and value creation.

The integration of our newest brands, Gin Mare and Diplomático continues to go well. The brands increased reported net sales in the first quarter by 2%, and we continue to expect these brands will be meaningful contributors to our long-term growth.

Also as a part of this portfolio evolution, we announced the sale of Finlandia Vodka earlier in the quarter. Finlandia has played an important role in the global growth of Brown-Forman since it joined our portfolio fully in 2004, and we appreciate the many talented employees who worked hard over the 2 decades to build the brand. We know this brand will continue to evolve in the capable hands of Coca-Cola HBC when the sale closes in the second half of the 2023 calendar year.

Before turning the call over to Leanne, I'd also like to add some additional perspective on our gross margins and operating expenses. In the first quarter of 2024, our reported and organic gross profit increased 5%, both ahead of the respected top line growth rates. While we experienced some headwinds in the form of higher input costs and the negative effect of foreign exchange, they were more than offset by the tailwinds of favorable price/mix, lower supply chain disruption related costs and lower tariff-related costs due to the removal of the U.K. tariffs on American whiskey. This resulted in 90 basis points of gross margin expansion in the quarter.

We continue to be focused on the execution of our long-term pricing strategy and believe the health and relevance of our brands, supported by our continued brand-building investments will allow us to continue to achieve our strategic priorities.

Our brand-building investments were evident in our first quarter as organic advertising expenses grew 14%. This was largely due to the timing of our increased spend to support the launch of the Jack Daniel's and Coca-Cola RTD, which, as I mentioned earlier, is significantly skewed to first few months of our fiscal year as well as increased investment for Jack Daniel's Tennessee Whiskey.

We also continue to invest behind our people. Organic SG&A investment increased 12%, driven primarily by higher compensation-related expenses related to organizational changes including our route to consumer expansions, which we believe will support Brown-Forman's long-term success.

In summary, we're off to a good start in fiscal 2024 and remain optimistic that we can achieve our full year goals. While consumer demand for our brands begins to reflect a normalization back to our more historical trends, we expect to continue to benefit from our long-term pricing and revenue growth management strategies as well as a more normalized cost environment. We're still operating in a highly dynamic world. Yet we have remained agile, focused and committed to the long-term growth of our people, our brands and our business. We take pride in our ability to deliver consistent and reliable growth year after year, decade after decade, and we believe this tradition of excellence will continue in fiscal 2024.

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

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. As Lawson mentioned, I will provide additional details on our geographic performance, other financial highlights as well as our fiscal 2024 outlook.

From a geographic perspective, collectively, our emerging international markets continued to deliver very strong double-digit organic net sales growth, driven by Jack Daniel's Tennessee Whiskey, particularly in the United Arab Emirates due to increased distribution and strong consumer demand in Türkiye, where the premium whiskey category is accelerating.

Jack Daniel's Tennessee Honey led by Türkiye as well as Brazil, where the brand is returning to normal levels of supply and new mix, which continues to grow strong double digits in Mexico, where the RTD category is accelerated, and we are gaining share. As the international airline travel and cruise business continued to return to more normalized growth levels, the travel retail channel grew organic net sales 9%, led by higher volumes of Woodford Reserve. Our business in this channel continues to remain above pre-pandemic levels.

Organic net sales for our developed international markets collectively were flat for the first quarter as growth in the United Kingdom, South Korea and Germany was offset by declines in Australia and Japan. Jack Daniel's Tennessee Apple was the largest contributor to growth driven by the successful launch of the brand in South Korea.

This growth was offset by year-over-year declines for Jack Daniel's RTDs, driven by Australia, where macroeconomic pressures negatively impacted volume growth and the United Kingdom, where we are transitioning from Jack Daniel's and Cola to Jack Daniel's and Coca-Cola partially offset the growth in Germany and Jack Daniel's Tennessee Whiskey, which had strong growth in the United Kingdom, but was negatively impacted by Japan due to an estimated net decrease in distributor inventory where we remain on track for our transition to own distribution on April 1st of this fiscal year.

And for the United States, organic net sales decreased 9% as a result of lower volumes due to an estimated net decrease in distributor inventories of 11%, partially offset by higher prices across our portfolio. As Lawson highlighted, in the first quarter, we cycled against the significant inventory rebuild during the same period last year, which was particularly impactful to the United States market as we focused on rebuilding distributor inventory for brands with substantial volume in the U.S., including Woodford Reserve, Gentleman Jack, Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Fire.

With the rebuilding of finished goods inventory across the 3-tiered system, we accomplished in fiscal 2023, we believe that distributor inventories have returned to more normal levels. The consumer premiumization trend continued to drive demand for our super premium Jack Daniel's products and partially offset the decline.

This included growth from Jack Daniel's Sinatra, our specialty launches such as Jack Daniel's Single Barrel Rye, Barrel Proof and the newest member of our Bonded series, Jack Daniel's Bonded Rye. These products highlight our whiskey credentials and give consumers the opportunity to explore and discover within the Jack Daniel's family while premiumizing the Jack Daniel's family of brands.

The Tequila category also continued to experience growth in the United States with El Jimador leading the growth of our Tequila portfolio, delivering double-digit organic net sales growth and the launch of Jack Daniel's and Coca-Cola RTD drove a high single-digit organic net sales increase for the Jack Daniel's ready-to-drink portfolio.

From a takeaway perspective, the data reflects a normalization as total distilled spirits as well as Brown-Forman delivered value growth in the mid-single digits, driven by growth in RTDs, Tequila and U.S. whiskey. As Lawson shared, the details of our gross margin expansion and operating expenses for the quarter, I will now turn to our operating income. In total, reported and organic operating income decreased 4% and 6%, respectively, in the first quarter of fiscal 2024, largely driven by the phasing of our operating expense growth, partially offset by our gross margin expansion. These results, combined with a decrease in our effective tax rate and an increase in interest expense resulted in a 7% diluted EPS decrease to \$0.48 per share.

And finally, to our fiscal 2024 outlook which we are reaffirming. In what has been a highly dynamic operating environment, we continue to be optimistic. We continue to believe global trends will normalize after 2 years of very strong growth. And while consumer

demand for our brands is also starting to reflect more historical trends, we expect to continue to grow on this elevated base as a result of our long-term pricing and revenue growth management strategies as well as the addition of 2 super premium brands, Gin Mare and Diplomático to our portfolio, partially offset by a portfolio mix shift to RTDs.

We'll also note that due to the timing of the Gin Mare and Diplomático acquisitions, which were in the third quarter of fiscal 2023, the contribution of these brands in the first half of fiscal 2024 will only appear in our reported results as the operating activity in this period will be noncomparable year-over-year. Once we lap the acquisitions, the results will then be included in our organic results. While we remain cautious due to the current macroeconomic volatility and the potential impact of inflation on consumer spending, we maintain our belief that the collective strength of our U.S. and international markets, along with the travel retail channel should reflect our longer-term growth algorithm and therefore, reiterate our organic net sales growth expectation for fiscal 2024 in the 5% to 7% range.

Today, we have intentionally highlighted the impact of our results from the strong shipments in the year ago period related to the rebuilding of distributor inventories. As a reminder, we began rebuilding distributor inventories in the second half of fiscal 2022 through the first half of fiscal 2023. I also want to remind you of the stronger shipments associated with the launch of Jack Daniel's and Coca-Cola RTD in the United States in the back half of fiscal 2023 will have to be lapped in the second half of fiscal 2024. Both are reflected in our guidance. We believe inflation will continue to negatively impact our input cost which will partially be offset by lower year-over-year costs associated with the supply chain disruption we incurred in fiscal 2023.

On the topic of input cost I'd like to take a moment here to share some thoughts on the recent changes in the — ***indiscernible*** — pricing. As we have discussed with you over the

last few quarters, given the increase in tequila demand, there was a significant increase in the number of planting several years ago. We have long believed that this would lead to an eventual increase in supply and subsequent decrease in cost, assuming the tequila category remained strong.

In the last 3 months, we have seen a significant decrease in agave cost from MXN 28 to MXN 30 per kilo to MXN 16 to MXN 18 per kilo depending on the quality of the agave. While we are very encouraged that prices are finally coming down the benefits to our cost of goods sold will not be immediate for 3 reasons.

First, we have finished goods inventory produced prior to the reduction in agave prices that need to be sold. Secondly, more than half of our tequila is aged liquid for expressions such as Reposado and Anejo, which will require some time before it is bottled and sold. For our Blanco expression, we will begin to see a benefit more quickly, in addition and as we have shared, we both grow agave internally and source it externally, and this mix can vary based up our needs and the volume growth by expression. So while the overall agave pricing trend is increasingly favorable, we still believe that inflation will be a headwind for our overall input cost in fiscal 2024.

Turning our attention to the full year operating expenses. Our outlook continues to reflect a normalization of incremental advertising spend aligned with our long-term philosophy for advertising spend to be aligned with our top line growth.

And SG&A growth is still likely to remain higher than historical averages as we continue to expect higher compensation-related expenses and expenses related to the transition to own distribution in Japan. Based on these expectations, we continue to anticipate organic operating income growth in the 6% to 8% range for the full fiscal year. We also expect our fiscal 2024 effective tax rate to be in the range of approximately 21% to 23% and our capital expenditures to be in the range of \$250 million to \$270 million for the full year.

In summary, we have had a good start to fiscal 2024. The results reflect the continued normalization of consumer demand as well as the comparison against the very strong shipments related to the rebuilding of distributor inventories in the year ago period. They also include the benefit of our pricing strategy and the phasing of our brand investments. While our short-term organic results in the quarter were below our historical trends, we believe our brand and our business are healthy. We remain optimistic as we look ahead to the full fiscal year and are confident in our ability to deliver our near-term goals and our long-term strategy.

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

Question and Answer

Operator

— **Operator Instructions** — Our first question comes from the line of Nadine Sarwat with Bernstein.

Nadine Sarwat

I'd like to zoom in on the distributor inventory in 2 parts. So the first, could you just quantify how much of the change in distributor inventory was due to the tough comp you highlighted versus how much is due to actual distributor destocking? And if there is a fair amount of actual destocking, what is driving this? And then secondly, are you happy with current distributor stock levels? Or should we be expecting some destocking in the next quarter?

Leanne Cunningham

I'll start with the first part of your question, which is we have talked about the comp that we had in the first quarter compared to the comp that we had in the last – the first quarter of last year, when we had very strong shipments. And if you go back to our – what is that

point in time with the Schedule C, you would have seen the impact that we had there. So it is partially that we are comping the very strong comp. It's also – we don't see it as destocking. We have finally gotten our inventory levels back up to what we believe is normal. We've been working on that for a year and bringing you along in that story along the way.

What we see now is a change in distributor buying patterns in that other part that you're asking about. And it really comes back to, we continue that with lapsed everything related to the pandemic. We now have to comp the things related to supply chain disruption. And as we got into supply chain disruption, before that, we had a very consistent cadence and seasonality of our shipments.

But due to the various ways that we determined that we needed to rebuild our distributor inventories, first, prioritizing Jack Daniel's Tennessee Whiskey, which would have started in the second half of 2020 and then moving into the first half of 2023, where we were able to prioritize Woodford Reserve, Gentleman Jack and Jack Daniel's flavors, we also prioritized markets for the U.S. first and then Europe and emerging international as we worked our way through the rebuilding of the inventory.

So the cadence and timing of our shipments are abnormal from what we would – our historic norms. So once we're back into a stable inventory position for long enough, we believe that it will become less volatile and would be kind of backed to our historic norms. But again, for us, we have been working for a year to get back up to that normal level of inventory across the world, and we now believe that we're there. So I hope that helps.

Lawson Whiting

Let me try to add on to that, Nadine, a little bit, too, because I do want to make sure everybody sort of – I get that this is really confusing. And I do make sure reiterate really what Leanne said, that this is a comparison issue though, it is not a destocking, — *indis-*

cernible — why it's not a destocking because I know that would sort of feel normal at this point.

So but if you go – literally, you can go back 3 years, the summer of 2020 into the fall really into the spring of – I'm talking calendar years here, not fiscals. We – it was kind of the boom years. It was the post-COVID, Nielsen numbers were up at like 30% for everyone, and there was just an enormous uplift in the entire industry. You get to the summer of '21, it begins to show up in terms of glass shortages. Really for Brown-Forman, it's seemingly worse than everyone else. But we really began to have those challenges in the summer of '21, and it was a challenge for about 8 months, where we ran global inventories down so low, and that would be going so far as to say the consumer inventory, the retail inventories, layers of distributors have got very low and we had out of stocks all over the place.

We are, at that time, working very hard. We're diversifying our glass supply. We're moving bottling lines. We're doing all sorts of things to try to alleviate the glass shortage and it starts to come back right in the spring of '22. And as Leanne said, we prioritized Jack because at that point, the on-premise is opening around the world and we did not want to miss that. But so Jack Daniel's really begins to move and had a huge year in fiscal '22 and had a big year in fiscal '23 also.

So Jack gets replenished in the spring and into the early summer, but now you get into the summer of '22, which is the one we're comparing against as we said earlier good for Gentleman Jack, all 3 flavors and basically our whole portfolio really begins to come back online. Now the reason there's not a destock here, this is where it takes – it doesn't – you wouldn't think at first, but what was happening because retail inventories were so low that those cases of Woodford and the Gentleman Jack, the entire portfolio got to the distributor warehouse and they were outside the back door in about 20 minutes because

the retail environment was so desperate for the product. So our days never crept up. And so we haven't had to take them down. I mean, so it's not a days of inventory issue, and it's not a destocking issue. It's just these comparisons against some crazy quarters. And I'll finish this off, and I don't want to spend that much more time on this. But Q1 of last year, JD, Jack Daniel's Tennessee Whiskey was plus 21%, total company was plus 17%. So you're comping against numbers like that.

Q2, just a sort of foreshadow everyone is a big quarter, too. So we have another one as we continue to replenish these inventories through Q2 of last year and then the comps get much, much easier. But it's been a volatile ride. It's been a volatile ride for 5 years. But the business is solid. I think if you look at the Nielsen numbers, in particular right now, they're kind of – they've normalized. But as we said last quarter, normal is good.

We've got this business, I think, rolling in the right direction and momentum is good and the volatility, we don't love the volatility, but it is there. We've got a little bit longer to go, but I still argue or not argue, but I'm still venture to say that our underlying business is in pretty good shape.

Nadine Sarwat

All right. That's very helpful. So just to clarify, I know in the release you called out that it was partially due to the comp issue, are you saying that there is no destocking whatsoever? There isn't a change in distributor buying patterns more caution. This is purely a comp cadence issue? And then if you could just clarify what we should expect for Q2? Thank you.

Leanne Cunningham

Yes. So just for clarification, we said partially comping the rebuilding and it's also partially a change in the distributor buying patterns because we are off our normal cadence of shipments our historical trends because of how we chose to prioritize, how we rebuilt

our brands and in what markets we were rebuilding those. So over the longer period of time, that will begin to normalize.

Operator

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

Bryan Spillane

Thanks, operator, and good morning, Lawson, Leanne. So thanks for all of that commentary on inventory. And I guess if I were to sum it up, if you deplete 10 cases, you'll ship 10 cases, right? That's what the plan is built on.

Lawson Whiting

Pretty much.

Bryan Spillane

Okay. And then, Lawson, maybe could you just give a little perspective on depletions in the quarter. Volume depletions were up 1%. And so could you just kind of put that in context of – is that more or less in line with what you were expecting? Maybe what that looks like relative to the industry? There's a lot of focus right now on volume and volume growth and just what's happening with consumption, not just for Brown-Forman, just more broadly across I know our entire coverage, consumer coverage inverse. So just trying to get a sense of, if you could put that into perspective of just what you're seeing in terms of volume consumption trends and whether kind of a 1% to 2% type depletion is maybe what we should be thinking about in terms of Brown-Forman and maybe just the industry for the year.

Leanne Cunningham

I'll add some color to that. And if you look at Schedule B, you can see that really, for the most part, shipments and depletions are aligned except for where you – we get down to

the Jack Daniel's ready-to-drink and that's all about the launch of the Jack Daniel's and Coca-Cola in the U.S. So where we are right now is they're in line. Over a longer period of time as shipments over the last few years have been stronger than depletions as we've been working to rebuild inventories. We do expect that depletions would need to come back in line and will exceed our shipments in this year, is what is built into our guidance. So as we think about that, we will continue to update you as we go through the quarters. But right now, we still believe our depletions will be a bit ahead of our shipments as we go through this fiscal year.

Lawson Whiting

I mean, I think, [shared] part a little bit by geography. I mean, the U.S. market, if you look at GDS in Nielsen, it's sort of between 5 and 6, I think. We're right there, too. So the U.S. market, I mean, there's so much noise in the sales numbers, I know. But the U.S. market is in a pretty decent shape. It's definitely being elevated by the RTD piece of things. So I do – I think it's fair to say the full strength has the – some of it's comparisons, but the full strength market has softened a little bit.

But it's being made up for us for the most part in our international markets, which continue to be really strong in particularly the emerging markets, which really is in its third year of pretty outstanding growth. That growth is coming from a very wide variety of markets, which is always nice also. It's one of the – while we are so dependent on Jack Daniel's, when you talk about the international markets, there's so much geographic diversification that for instance, South America and Mexico, we've had an outstanding run and the markets in Eastern Europe that are on really strong runs right now. So we've got really strong pockets of growth coming out of some of the most important markets. U.K. is actually in pretty good shape right now, too, and is delivering well. So no, the business is not turning into a 1% growth. No one is thinking of that.

Operator

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

Eric Serotta

With regards to the comment that you made in the press release and on the prepared remarks about declines in the old Jack & Cola offsetting growth in the Jack & Coke launch. If I remember correctly, the previous comments that you made were that Jack & Coke was nicely incremental. So just looking for some color as to why they largely offset in the quarter. Was there a timing issue with getting some of the old Jack & Cola out of the channel or was some of this – a lot of this growth reported on Coke [stocks] and not yours. Any color into that dynamic would be very, really helpful.

Lawson Whiting

Yes. So sure, because this is one of the topics but also is a little bit confusing. So as I mentioned in my prepared remarks, the global volumes, it's about 1.8 million cases across the 11 markets. Now the part – I think most people know, but a reminder, I guess, some markets are led by Brown-Forman and others are being led by the Coca-Cola Company. So that is what is throwing some of our volume numbers off in the spreadsheet. And I think it's what you're referring to. There are markets where Coca-Cola is taking the lead, and I'll use the U.K. as a good – probably the clearest example.

We had a big Jack & Cola business there, and now we are evolving that over to Jack & Coke. So those sales of the actual sales to the Tescos of the world, will not be on our books anymore, it's going to be on the Coca-Cola's books. It doesn't mean the business is going away, it's just we're taking out the cola and replenishing or replacing it with Jack & Coke. And so that's why the numbers look like they're going down, but that's not really the case. In system-wide, they're not. It's just the way that's being reflected on our financial statements.

So and I think – look, I'd also reiterate, I mean, this has been a great launch. It's an iconic product. We are really investing highly behind this launch as is the Coca-Cola Company. And so – there's been a lot of broad reach media, there's events, there's trade execution, but it's [gone] and it is off to a very strong start.

So the increased visibility, I think, is important. The market share gains we're getting. We've got a lot of positive factors. So and it's got 2% of the category. In the U.S. It's got 2% share already, and it's only been 3 or 4 months. So it's off to a good start, and we feel pretty good about it. And I think the long-term potential is exciting and a lot of things that it does for the health of the brand, along with the actual business proposal itself. So it's off to a good start.

Eric Serotta

Great. And then just to follow up on the inventory dynamic. Hopefully, this is one of the last questions on it, but you did mention or you did flag rightfully so, I think some tough comp again in the second quarter. My recollection is the rebuild last year in the second quarter was somewhat less than it was in the first quarter. Am I remembering that correctly, and should we expect some sort of moderation in that year-on-year headwind in the second quarter before all things being equal, should be about neutral in the second half.

Leanne Cunningham

You're remembering that correctly. And what we're talking about as far as comp is the entire company because we had the really strong shipments in the first half of last year. But you are correct that as we get into the second quarter, the shipments and depletions more normalized. But the one thing we have to remember is, and we'll share this with you every quarter as we get into the fourth quarter of fiscal 2024, then we'll have to lap the launch of Jack Daniel's and Coca-Cola in the U.S.

Lawson Whiting

Yes. I mean, so it is less. Q2, I said a minute ago, Jack was still up 14% in Q2. So it's still – we've still got high comps, but it is normalizing.

Operator

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

Drew Levine

This is Drew Levine on for Andrea. So I wanted to pick up on the U.S. So it looked like underlying trends were up around 2% in the quarter and a loss as you mentioned TDS was up sort of mid-single digit. And the track channels, it looks like even Brown-Forman was stronger than that. So just curious if you can elaborate maybe on what the disconnect there is? And if we just see that sort of delta between the underlying growth rate and what we're seeing in track channels narrow looking ahead?

Lawson Whiting

Well, I mean, those numbers never tick and tie exactly. I think the 5% growth number, which includes Jack and Coke, it's a pretty solid sort of result. The U.S. for like a decade has been between 4% and 5% with the exception of these sort of post-COVID years when it really blew up. Yes, the difference between the – getting from minus 9 on organic basis and adjusting for the distributor inventories is what gets you to the two. I don't know if I can explain that the between the 2 and 5 necessarily. I don't think it's not a huge number.

Leanne Cunningham

It's really about the launch of the Jack and Coke and the buying patterns that are in there. So that's creating a lot of noise in the difference between what you would see in our takeaway trends and what's happening in our net sales. So it's just – again, as we were coming through and the gap was narrowing over the last few quarters, but then as we launched Jack and Coke and it's not all the way through into those takeaway numbers

yet. That's creating the gap for us.

Drew Levine

All right. Fair enough. And then if I could ask a follow-up on gross margins. So it looks like costs were about 100 bps headwind this quarter moderated from the fourth quarter, which I think was around [320] bps. And you mentioned you'll be lapping a lot of those supply chain mitigation efforts from last year. So can you maybe offer some more color on gross margin expectations looking ahead? Should we think about gross margins potentially over 60% here going forward? And then on the Blanco or agave situation. Is there any sort of way to think about the internal versus external mix of supply there?

Leanne Cunningham

Okay. Great. Thanks. So I'll start with our gross margin for the first quarter, which was, as you noted, expanded 90 basis points, and it's where our price/mix more than offset the inflation on our input cost. And it was really driven by our price mix, which was plus 250 basis points that was driven by kind of the price increases across our portfolio that was led by Jack Daniel's Tennessee Whiskey. We also still, and I'll just point this out, is the last time I'll have the opportunity to say it is the last of the benefit from the removal of the U.K. tariffs on American whiskey because they rolled off June 1 of '22.

And as you pointed out, the impact of inflation on our input cost has been partially offset by supply chain disruption costs. And then so that's a good segue for me to go into the full year. And again, everything I say here is built into our operating income guidance. But we do expect price mix to continue to be a leader for us this year with our long-term pricing and that new growth management strategies. We'll have the – from a cost perspective, we'll have the absence of the supply chain disruption costs that will be significantly less to zero in F '24. And we'll still have inflation that will negatively impact our input cost in total, but though at a lower level.

And to your question, I'll talk to you about a couple of our key input items starting with agave. And it really is about what we said. We've been talking about this for a very long time. We're really excited that it's finally starting to come down. We've been looking out there for such a long period of time seeing those large number of plantings and waiting for supply to catch up with the demand, and we are approaching and arriving to that now.

We just wanted to be clear, though, with everybody, though, like we said in our prepared remarks, we do have finished cases in the supply chain - in the supply chain and our inventory that need to be sold through, and it varies back to how much inventory we have, but generally speaking, that would be 3 to 4 months depending on SKUs. So well, we need to work through that.

And then like we talked about for our portfolio of tequilas, Reposado and Anejo and some of our other expression are aged liquid. So we need to continue to let them, go through their aging cycle before they're bottled and the inventory is sold through. But as we get to expressions like Blanco or any nonaged expressions, we'll see that benefit more quickly.

So it's really more about the inventory - moving through the aged liquid and the finished goods inventory. Though there a bit of it will be the mix, just between what do we need to meet our needs. So we do grow our own internal agave. And but where we have needs, we source on the spot market. As you know, we've been clear with that over time.

So balancing all those things, I think I'll just say that in a number of months from now, we're going to continue - we're going to see a meaningful benefit that will come towards the end of our fiscal '24 and well into F '25, which continues to make us excited about as we look ahead because we know agave and the cost of wood have been our 2 biggest challenges over the last number of years as it relates to our costs.

And just to give you a quick update on wood while I'm here, the commodity cost for wood

continues to remain high, but we have made a lot of strategic changes to our wood supply chain that is beginning to benefit us and yield those benefits. And we continue to believe, we are going to continue to see those benefits as we move through '24 and then well into the future as well. So we've got that position well. I'll real quickly hit just in case anybody is curious [bringing] for us, which is largely corn. It's below its peak.

We're expecting it to be stable but well below kind of the prior year's prices. And with the reduction of natural gas and diesel prices, we will still see a bit of a slight increase in our glass cost but less than what we've had. So all in all, this is built into our guidance. And in total, our cost trends are moving and appeared to be moving in a favorable direction for us. So I hope that helps as you think about gross margin where we were for the quarter and kind of where we're thinking for the full year.

Operator

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

Vivien Azer

I was hoping to ask about advertising spending a little bit. Understanding that the growth this quarter is really a phasing, and we heard you loud and clearly on kind of the longer-term aspiration to grow A&P in line with sales. But Leanne or Lawson, I was just curious how you're viewing the evolution of the competitive dynamic in TBA in the United States, for a whole host of reasons, a number of large public beer companies are stepping up their A&P for the remainder of the year. I'm just wondering how you're thinking about the potential impact on the sell spirit sales as a result and the potential need for you guys to spend more.

Lawson Whiting

Yes. I mean I had not heard that the beer companies were really stepping up that much. But I do think, as you said, the long-term philosophy is to keep it in step with sales. We

have significantly increased our [thought of] spending in the last 2 years by well over a \$100 million. And so I think we feel pretty good that we have gotten ourselves in a comfortable place. And I think we can manage the P&L from there. I mean, look, the beer companies are struggling. And so they are – I'm quite sure they are trying to figure out ways to obviously turn their brands around, some brands are in real trouble. And they're going to find a way to try to spend their way out of that. But I don't see us doing that. And I don't really think, at least in the short term, I don't see much of a reaction out of us because of that. Their challenges are sort of unique to them, and we'll continue to [pop] forward the way we have.

Leanne Cunningham

Yes. And if you don't mind, Vivien, I'll kind of scope back out, and I'll kind of talk about our full year because I think we need to put what happened in Q1 into context with how we're thinking about the full year. So I'm going to go a little bit broader first, just to say, like I've shared, we've left the impact of the pandemic to a more normalized level, and we're on that elevated base. We're still lapping impact of just supply chain disruption. But the reasons we believe that we're going to deliver our full year guidance is we lap those strong shipments of the rebuilding of our distributor inventory.

And like we talked about here today, once we adjust for the estimated net change in distributor inventories that you've seen on Schedule D, we believe our brands and our business are really healthy. So I'll tie that back to how we're investing in it. The investment really kind of came with the launch of Jack Daniel's and Coca-Cola in the U.S. We are getting ready to launch that in September, which is just a few days away in Germany. So when Lawson said in his prepared remarks that the majority of that hit in the first few months of the year, is to support those launches, and we're going to get back to that normal trend.

But I think it's important to go ahead and say, for our full year, we've got our pricing and our revenue strategies, we've got the addition in the back half of the year. That's not in the first half of the year, which is the impact of Gin Mare and Diplomático that will be moving into our organic results.

So we feel good about our top line guidance. We also feel good about the absence of supply chain disruptions and the costs associated with that. We feel good that from a full year perspective, we will invest in our brands in a way that lands with how we planned it, which is in line with top line growth that heavily skewed to the front end. And that, we've said this already, but from an operating expense perspective, SG&A, we continue to invest in our route to consumers. We know that's Japan and also Slovakia for fiscal 2024. And we've got all this built into our guidance. So even with all the noise that we're talking through today, we believe we're going to land our operating income growth at that 6% to 8%.

Lawson Whiting

In fact one more comment on the beer versus spirits thing more to the RTD world. I think it's just – and they need to advertise because the malt-based RTD is obviously have gone through a huge amount of — ***indiscernible*** — in the last few years where they exploded and then they've taken a sharp dive. Most a lot of it is coming at the expense of the spirit-based RTDs which I just – I found interesting. I don't think any of us predicted that to happen. But I think at the end of the day, the consumer is willing to pay more substantially more for spirit-based RTD, than a malt-based RTD because they taste better.

And that is making the numbers get a little bit wild in the world of Nielsen and all the rest of it. But I think we have – we, not Brown-Forman, but I mean, the industry is showing that the consumer is willing to pay a little bit more for something that tastes really good. And it's been interesting to watch those dynamics.

Vivien Azer

Absolutely. If I could just squeeze in a quick follow-up on Japan specifically. We've observed Brown-Forman evolve the route-to-market process in a number of different markets historically. I've never seen this much dislocation. So can you just help us think through the 80% decline in Japan and how that evolves over the course of the year?

Leanne Cunningham

Yes. So again, we've been working, again, scoping out, working on our, increasing our route to consumer into own distribution models for quite some time. We've had prior to 2020 – fiscal 2024, we've had 14 markets move into own distribution. We've seen a lot of success. They deliver a lot of things like they fuel our growth, strengthen our position. They do unlock value for us, and we're continuing to move forward in that. So specifically, in this year as it relates to Japan, we are in the process of transition. We know that if you were to look at a year ago period, we were with our distributor partner. We had inventory in that market to supply the sales, and we're going through just the transition. And so as we – again, all of this is built into our full year plan. But again, at fiscal 2024 for us is going to be a year of transition in Japan. And with that, we have SG&A costs associated with it, and we have a bit of volatility in our inventory levels as we make that transition.

Operator

Our next question comes from the line of Bill Kirk with ROTH MKM.

William Kirk

I wanted to ask about your inventory levels, not necessarily the distributor levels. Naturally, they're up from the glass shortage error. You highlighted that. However, if I go back further, I have the days up about 25% over fiscal '19. So I guess, how do you feel about the amount of inventory you hold?

Leanne Cunningham

So what I would say and you can probably see some of this on a cash flow statement is that, again, as we compare to a prior year period where we were working really, really hard to get all of the supply chain replenished with finished goods inventory. We now have what we've talked about, all of the parts of the chain replenished, including our own inventory. We go into probably the important holiday selling period ready to supply that. So we believe by the time, it's a bit high right now, again, if you look for our own inventories. But as we go through the holiday period, we will, by the end of the year, our plan is that we have that work down and then our own inventories, too, are back in the normal. That's the last piece of the chain that we will be normalizing and we are ready to make those shipments for the holiday season.

William Kirk

Okay. Excellent. And then there were 2 comments I want to try to tie together. I think Lawson, you made both of them. One was you mentioned that absent distributor inventory changes, net sales would have been above long-term growth expectations. But you also suggested that 1% depletions are below what people should expect going forward. So I guess how are the net sales ex-shipment timing above long term, but the completions below long term? I'm having a little trouble with those 2 comments.

Lawson Whiting

Well, that's just going straight to that Schedule D. So that's where we would I think Leanne said, if you adjust the distributor inventory topic, we'd be running it at an 8% top line. So that's the reference to the higher than sort of - higher than historical norms in terms of sales growth. And that's the part that gets - honestly gets us feeling confident because that number is pretty healthy.

Now the 1%, I think we talked about that a few minutes ago, there's a lot of RTD movement in there, it's suppressing it. And the other part of it is volumes. We've taken a lot of

pricing. I think that contributes to it too because we're getting more of our sales growth now is coming from pricing than it has over the historical periods. So it's a little bit of a balance.

Operator

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

Stephen Robert Powers

I had 2 follow-ups on 2 different questions. The first one, just quickly on the agave topic, Leanne. Is there a way to summarize or quantify the percentage of the company's agave needs that you currently have the capacity to self-grow versus source externally?

Leanne Cunningham

We've never shared that then and it changes over time depending on the category, demand, our finished goods inventory, our liquid inventory. So it does ebb and flow and we do grow our own and we supplement it with the external as we see demand above what we are able to grow ourselves and then our sourcing strategy that's implied in there. So again, we are excited that is finally coming down, that supply is coming on. We continue to think that, that's going to be a tailwind for us as we move through F '24 and well through F '25.

Stephen Robert Powers

Okay. Okay. Fair enough. And then probably Lawson for you. On Jack & Coke, I was wondering if you could talk at all about through the incremental distribution gains, new launches that are planned over the balance of the fiscal year, that should I think at least partially offset the tougher comp in the fourth quarter as you lap the U.S. launch. Any perspective there would be helpful. But also, love, if you have it, any details on consumer repeat rates or what have you. The trial has been great. Just curious as to how much of the demand we are seeing is incremental, like first-time trial versus repeated consumption.

Lawson Whiting

All right. Let me answer the second one, first a little bit because it is – we were obviously getting prepared for this, I knew that question would come. It was very difficult to get sort of terms of repeat purchase rates. It's just too early. We're getting massive distribution flow and that has been impressive and very good. And so we've essentially reached most of our goals in a pretty short period of time. But we just don't have that. We'll have that – I assume by next quarter, we'll probably have some indications on that, that will be a little bit better, but it's just playing too early.

Now as the year – as the year goes on, the highlight or the highlights, I guess, we've launched in the U.K. We've launched in Spain and Poland, and all has gone pretty well, and I think we've talked about that. We're really, the big one that's coming is Germany. So that's going to happen in September. And Germany is a very large RTD market for Brown-Forman. And so sort of getting that right is obviously going to be very important, but that will be exciting to watch, and we'll see how that goes.

And then Coca-Cola is taking it in a lot of other – getting bigger in a lot of other markets, places like Japan, we talked about the Philippines, the U.K., Poland, Hungary, Netherlands, Ireland. So the international rollout continues throughout this fiscal year.

Operator

Thank you. Ladies and gentlemen, due to the interest of time, I would now like to turn the call back over to Sue for closing remarks.

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 2024 Earnings Call. If you have any additional questions, please contact us. We do look forward to presenting at the Barclays Global Consumer Staples Conference next week, and we hope to see many of you there.

For those of you that are unable to attend the presentation will be made available as a webcast, accessible via the Brown-Forman corporate website under the section titled Investors, Events and Presentations. We also want to wish everyone an enjoyable weekend, particularly those in the United States that will be celebrating the Labor Day holiday. And on September 2, we hope you will join us in raising a glass as we say happy birthday to our founder, George Garvin Brown. Cheers, everyone. 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.

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