Brown-Forman Corporation, Q3 2024, Earnings Call 2024-03-06

Presentation

Operator

Good day, and thank you for standing by. Welcome to the Brown-Forman Third Quarter and Year-to-Date Fiscal 2024 Earnings Call. — ***Operator Instructions*** — Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Sue Perram, Vice President, Director, Investor Relations.

Susanne 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 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 third quarter and 9 months ended January 31, 2024, in addition to posting presentation materials that Lawson and Leanne will walk through momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations.

In the press release, we have listed a number of the risk factors you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K and Form 10-Q reports filed with the Securities and Exchange Commission. During this call, we will be discussing certain non-GAAP financial measures. These measures, a reconciliation to the most directly comparable GAAP financial measures and the reasons management believes they provide useful information to investors regarding the company's financial condition and results of operations are contained in the press release and investor presentation. With that, I would like to turn the call over to Lawson.

Lawson Whiting

Thank you, Sue, and good morning, everyone. Thank you for joining us today as we share our third quarter and year-to-date results for fiscal 2024. Before we get into the specifics of Brown-Forman's performance, I wanted to take a moment to offer a few comments about the dynamics and trends within the broader spirits industry. The last few years have been some of the most volatile and complex in my 26 years in the spirits industry with a variety of factors creating noise within the system. This can make it hard at times to distinguish between short-term headwinds and long-term trends.

The last few months have been particularly noisy as demand for spirits has been normalizing after more than 2 years of outstanding growth. To truly understand the current environment, however, it's important to reflect back on the beginning of the pandemic when the closure of the on-premise limitations on travel and remote work prompted many consumers to shift their spirits consumption from bars and restaurants and invested at home bars for entertaining. Once restrictions eased and bars, pubs and restaurants reopened, consumers began spending heavily on vacations and other experiences they missed during the lockdowns. In addition, many consumers continue to entertain at home. Many in our industry call this the COVID supercycle.

In calendar 2023, after 2-plus years of above average spending, consumers were getting back to more normal consumption patterns but were soon faced with high inflation and increased interest rates that made them reconsider when and how they purchase spirits. By the late summer of 2023, the Spirits industry across much of the developed world, including the U.S., saw the impact of these changing consumer behaviors in the form of weakening takeaway trends. However, we continue to believe, as we mentioned last quarter that these trends are a direct result of the volatility consumers experienced since the pandemic and do not imply a longer-term change in the way they consume and enjoy Spirits.

At the same time, consumers were adjusting their behavior as a result of the pandemic. Brown-Forman had its own set of pandemic-related challenges to navigate. This included disruptions to supply chain logistics and glass supply constraints that impacted our historical distributor ordering patterns and created unusual comparisons over the past few years. Today, we have a supply chain that is adjusting back to normal levels of consumer demand, and at the same time, it's also facing increased inflation, increased interest rates and increased competition. I share all of this to try and bring clarity to the difficult dynamics we've had to navigate and to explain why despite a challenging fiscal year, we continue to remain confident in the long-term health of the spirits consumer and the spirits industry.

The other very important topic for Brown-Forman this fiscal year is the improvement in our gross margin. This too has been a journey we've been on now for several years. We've continued to execute our pricing strategy through our enhanced revenue growth management capabilities and increased price. We've benefited from the growth of our super premium brands in the form of more favorable price mix and these improvements, along with the absence of the supply chain disruption costs in the year ago period more than offset higher input costs, and we're pleased with our strong gross margin expansion.

Now let me provide a bit of perspective on our fiscal 2024 net sales. Our reported net sales growth increased 1% in the 9 months of fiscal 2024 with flat organic net sales growth. These results compare against strong results in the prior year where strong consumer demand, higher pricing and the rebuilding of distributor inventories generated high single-digit reported net sales growth and double-digit organic net sales growth. I encourage you to reference Schedule D, which illustrates 5 percentage points of impact to our organic net sales from an estimated net decrease in distributor inventories. If you factor in this impact, our top line results continue to be in the range of our longer-term trends and help support our belief that our business is solid and our brands remain healthy.

In the 9 months of fiscal 2024, the largest growth contributors to organic net sales growth were in Jack Daniel's Tennessee Apple, New Mix and Glenglassaugh. As you will recall, the international rollout of Jack Daniel's Tennessee Apple had been slowed by the pandemic-related impacts. However, as supply and logistics challenges were eased we were better able to meet consumer demand, which drove growth for Jack Daniel's Tennessee Apple, particularly in markets such as Brazil and Chile. We've also had a strong launch in South Korea, resulting in very strong double-digit growth for the brand.

Despite a challenging environment in Mexico, New mix continued to deliver double-digit organic net sales growth as the brand benefits from higher pricing and continues to gain value share in the RTD category. Glenglassaugh continues to be a standout brand as its awareness and prestige among whiskey connoisseurs continues to grow. As we discussed last quarter, the brand continued to benefit from CASK sales through its old and rare program. In addition, Glenglassaugh Sandend was named the 2023 Whiskey of the Year by Whiskey Advocate Magazine. This is our second year in a row that a Brown-Forman brand has received powerful and impactful acclaim from whiskey critics across the globe.

If you'll recall, Jack Daniel's Bonded captured this most coveted global accolade in the whiskey industry back in 2022. Since I mentioned Jack Daniel's Bonded, I'll also note that collectively, the Jack Daniel's super-premium expressions delivered strong double-digit organic net sales growth in the year-to-date period. This growth was led by Jack Daniel Sinatra, Jack Daniel's Single Barrel Rye Barrel Proof and the newest member of the bonded series Jack Daniel's Bonded Rye. This is the result of our purposeful efforts to premiumize the Jack Daniel's family of brands and elevate our whiskey credentials through innovation and special launches. In doing so, we give both long-term friends of Jack Daniel's and new friends, the opportunity to explore and discover within the Jack Daniel's family.

Also included in this innovation is the Jack Daniel's and Coca-Cola RTD, which just celebrated 1 year since the national launch in Mexico. While it's still early to the brand's global launch, the Jack & Coke RTD has earned numerous awards, including best canned cocktail and best drink concept by Beverage Digest and named the Coca-Cola Company's #1 innovation in 2023. Jack & Coke is the #1 RTD SKU in Great Britain and Poland and remains the #1 whiskey-based RTD in the United States. And in less than 12 months, over 100 million cans have been sold in just 13 markets, increasing brand visibility not only for the RTD, but also for Jack Daniel's full-strength portfolio.

The Jack Daniel's RTD portfolio had minimal impact on the overall organic net sales results in the year-to-date period, largely due to the transition of the Jack and Cola business to Jack & Coke. We believe this transition is building a stronger, more premium and more global foundation that creates value and supports our long-term growth.

The benefits from the premiumization trend continue to be evident in the organic net sales growth of Woodford Reserve, which returned to growth in the year-to-date period, driven by the brand's luxury expressions such as Batch Proof and the Masters Collection. Our founding brand, Old Forester, introduced the newest expression in its super premium Whiskey Row series Old Forester 1924, a 10-year-old whiskey with a suggested selling price of $115.

The Whiskey Row series continues to grow but also creates a halo for the parent brand, and I'm proud to say that Old Forester has recently crossed the 0.5 million 9-liter case milestone. And our newest super and ultra premium brands, Gin Mare and Diplomatico entered our organic results in the third quarter and collectively delivered a very strong double-digit organic net sales growth.

To wrap up our top line performance, I'll share a few thoughts on Jack Daniel's Tennessee Whiskey, which was the largest offset to growth of our organic net sales. First of all, it is lapping an exceptionally high comp from the prior year period. Also, volume declined in the 9 months of the fiscal year, mainly related to our route-to-consumer transition in Japan, the U.S. and the comparison against the inventory rebuild in Sub-Saharan Africa in the year ago period.

We believe these disruptions are circumstantial and temporary and are confident that Jack Daniel's remains in a position of strength with robust medium- and long-term performance and exceptional brand health. For example, Jack Daniel's Tennessee Whiskey has again been named the most valuable spirits brand in the world by Interbrand, making this the eighth year in a row. In fact, based on our consumer insights research, Jack Daniel's Tennessee Whiskey ranks #1 or #2 across the measures of brand awareness, penetration and consideration across most markets. And we continue to support the brand's health and growth through the Make It Count global campaign, the Jack & Coke RTD and the McLaren Formula 1 sponsorship. We have strategies and plans in place to return Jack Daniel's Tennessee Whiskey to growth which we will share in more detail during our Investor Day later this month.

While the path to normalization in the spirits category impacted our top line results, we continue to be pleased with our gross margin. As I shared previously, we have moved from contraction to expansion in the first 9 months of fiscal 2024, our reported and organic gross profit increased 5% and 6%, respectively, both were ahead of the respective top line growth rates. The strength and health of our brands, along with our continued brand building investments enabled us to increase price across many brands in our portfolio, which helped drive the 290 basis points of price/mix contribution to gross margin.

Gross margin also benefited from the absence of supply chain mitigation costs, which more than offset higher input costs. As a reminder, in the prior year-to-date period, we incurred increased transportation and logistics costs in order to satisfy the demand from our distributors and retailers for the important holiday season. In total, favorable price mix the absence of supply chain mitigation costs and lower tariff-related costs due to the removal of the U.K. tariffs on American whiskey more than offset higher input costs and the negative effects of foreign exchange and acquisitions and divestitures. This resulted in 250 basis points of reported gross margin expansion in the year-to-date period.

In summary, we continue to operate in a very dynamic operating environment that has impacted our short-term results. We believe that we will benefit from the evolution of our brand portfolio, long-term pricing and revenue growth management strategies as well as a moderating cost environment even as consumer demand normalizes. The spirits category offers attractive growth, healthy margins and high returns on capital, and we're well positioned globally with the premium and super premium brands in growing categories. We also have an organization of highly talented people who are committed to our strategic priorities and company values.

I'd like to thank all of our Brown-Forman employees across the world for their focus on growing our brands and achieving our long-term ambitions. With that, I'll turn the call over to Leanne and she'll provide additional details on our geographic performance, other financial highlights as well as our updated fiscal 2024 outlook.

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. From a geographic perspective, our emerging international markets collectively delivered 11% organic net sales growth and continue to lead the company's growth in the year-to-date period. Jack Daniel's Tennessee Apple, particularly in Brazil and Chile, once again led the growth due to our ability to meet strong consumer demand with the return of normal levels of supply. Jack Daniel's Tennessee Whiskey growth was led by Türkiye as momentum in the premium whiskey category continued. In Mexico, New Mix continued to deliver strong double-digit growth as the brand continued to benefit from our pricing strategy and gained share of the RTD category.

In the travel retail channel, organic net sales grew 1% in the 9 months of the fiscal year, which is impressive as it lapped 52% growth in the year ago period when international airline travel and the cruise industry rebounded and nearly returned to pre-COVID levels. Strong double-digit growth of our super premium American whiskeys such as Woodford Reserve, Jack Daniel's American Single Malt, our exclusive global travel retail offering and Jack Daniel's Single Barrel was partially offset by declines in Jack Daniel's Tennessee Whiskey and Jack Daniel's Tennessee Honey.

Turning to the United States. Organic net sales decreased 2% driven by lower volumes, partially reflecting an estimated net decrease in distributor inventories of 2%. The impact of our year-to-date results due to the comparison against the significant inventory rebuilding during the first half of fiscal 2023 moderated as we believe distributor inventories normalized in the third quarter of fiscal 2023 and have remained at normal levels. Our pricing strategy, which led to higher prices across much of our portfolio, led by Jack Daniel's Tennessee Whiskey and el Jimador helped to limit the decline. Consumer demand for U.S. whiskey, particularly super premium remains strong as U.S. whiskey is the second largest contributor to total distilled spirits value growth in Nielsen.

The demand for our super premium Jack Daniel's products, Jack Daniel Sinatra, Jack Daniel's Single Barrel Rye Barrel Proof and Jack Daniel's Bonded Rye along with our limited releases of Jack Daniel's 10- and 12-year old delivered strong growth and partially offset the decline in Jack Daniel's Tennessee Whiskey volume. The fastest-growing category in the U.S. remains the ready-to-drink category. It has been nearly 1 year since the launch of the Jack Daniels and Coca-Cola RTD in the United States, and the brand continues to grow and gain share.

Jack Daniel's RTD, led by Jack & Coke remains a top 10 brand family by value in Nielsen. We continue to believe that our portfolio is well positioned to benefit from the consumer trends of premiumization and convenience. Moving on to our developed international markets. Collectively, organic net sales declined 6% for the 9 months of fiscal 2024, driven by lower volumes, primarily reflecting an estimated net decrease in distributor inventories of 6%. The growth of Jack Daniel's Tennessee Apple, led by the continuing successful launch in South Korea and Glenglassaugh's old and rare cask sales in Singapore was more than offset by declines Jack Daniel's Tennessee Whiskey in Japan related to the estimated net decrease in distributor inventory due to the fulfillment of backlog orders in the second half of last year when supply was available to meet this demand coupled with the transition activities to our own distribution. We continue to progress as planned with our launch just a few weeks away on April 1.

In addition, as we continue to drive and build our business in Europe, we are pleased to announce that we will establish our own distribution organization in Italy effective May 1, 2025. Italy is one of the top 5 spirits markets in the European Union, making it an important market for driving the growth of our Jack Daniel's family of brands globally and in particular, for our latest portfolio additions. Italy is the largest market for Gin Mare and the fifth largest market for Diplomatico rum globally. This market holds significant potential for future growth, and we believe this change will enable us to strengthen our commercial and brand-building capabilities while increasing consumer focus and prioritization of our portfolio.

As Lawson has shared the details of our strong gross margin expansion for the 9 months of fiscal 2024, I will now turn to our operating expenses and income. As we have shared with you in prior quarters, we allocated more brand-building investment in the early months of fiscal 2024 to support the launch of the Jack Daniel's and Coca-Cola RTD in the United States. We also increased investment for Jack Daniel's Tennessee Whiskey due to the phasing of our investments, our operating expenses continued to moderate through the 9 months of fiscal 2024, which resulted in organic advertising expense growth of 7% in the year-to-date period.

Similarly, organic SG&A investment also moderated through the 9 months of fiscal 2024 as we continue to invest behind our people. Primarily led by higher compensation and benefit expenses, resulting in an increase of 8% for the year-to-date period. Our year-to-date reported operating expenses, which decreased 11% were impacted by 3 items. The absence of the prior year noncash impairment charge for the Finlandia brand name, the current year gain on the sale of Finlandia and the absence of the prior year post closing costs and expenses related to the acquisition of Diplomatico and Gin Mare.

In total, reported operating income increased 25% and organic operating income grew 2% in the 9 months of fiscal 2024. These results led to a 32% diluted earnings per share increase to $1.58 per share. Before moving to our outlook, I'd like to take the opportunity to provide you with an update on our share repurchase program that we announced on October 2, 2023. As you may recall, the Brown-Forman Board of Directors authorized the repurchase of up to $400 million of our outstanding shares of Class A and Class B common stock. I am pleased to announce that as of December 31, 2023, we have completed the program.

Now turning to our updated fiscal 2024 outlook. As Lawson highlighted, global trends are normalizing after 2 years of very strong organic net sales growth in what has been a challenging and dynamic operating environment we experienced softer-than-expected consumer trends during the important holiday selling season globally, which limited our expected top line acceleration. While we have to lap stronger shipments associated with the launch of Jack Daniel's and Coca-Cola RTD in the U.S. in the fourth quarter of fiscal 2023, the year ago period is in line with longer-term historic trends. We also expect to continue to benefit from our long-term pricing and revenue growth management strategies as well as the contribution from our recent super premium brand acquisitions, Gin Mare and Diplomatico.

We now expect our organic net sales growth to be flat for fiscal 2024. Also in this fiscal year, we continue to believe our gross margin will expand as higher input costs driven by inflation will be more than offset by price mix and the absence of supply chain disruption. Our outlook for organic operating expenses to increase remains the same and assumes incremental advertising spend will be above our top line growth rate. Our expectation is that SG&A growth will remain higher than historical averages as we continue to expect higher compensation and benefit-related expenses and costs related to our transition to own distribution in Japan.

Based on these expectations, we anticipate organic operating income growth to be in the range of 0% to 2% for the full fiscal year. We have revised our expectation for the effective tax rate for fiscal 2024 to now be in the range of approximately 20% to 22%, and we now anticipate capital expenditures to be in the range of $230 million to $240 million for the full year. Before opening the call up to Q&A, I would also like to add a few comments on our recent capital allocation actions, in particular, the sale of our cooperage in Alabama, the pending divestiture of Sonoma-Cutrer and our long-standing commitment to our community and the environment. During the third quarter, we announced the sale of our cooperage in Trinity, Alabama to Independent Stave Company.

In our continuing efforts to optimize our wood supply chain, we have committed to a long-term strategic relationship with Independent Stave Company to ensure a stable supply of high-quality barrels to meet our demand at a competitive price while creating efficiencies and optimizing capital allocation in our supply chain. The relationship also allows for the expansion and diversification of our supply chain network. Brown-Forman will continue to own and fully leverage the Brown-Forman Cooperage in Louisville, Kentucky. This allows us to produce approximately half of the barrels required to support our needs while enabling us to continue developing and innovating for our brands and new expressions.

Moving to Sonoma-Cutrer the divestiture to o The Duckhorn Portfolio and the assumption of an equity ownership position in the company subject to certain customary closing adjustments and conditions is still expected to close in the fourth quarter of fiscal year 2024. We continue to believe in the strength of the Sonoma-Cutrer brand and its future growth opportunities and that this transaction reflects our portfolio evolution strategy as well as our commitment to long-term value creation. And lastly, I would like to share that we have recently announced that in fiscal 2024, we have committed to a $22.5 million investment benefiting the Brown-Forman Foundation and Dendrifund.

Brown-Forman Foundation was created in fiscal 2018 with the goal of helping fund our ongoing philanthropic endeavors with a focus on our corporate hometown of Louisville, Kentucky.

The Dendrifund, a nonprofit seed fund created by Brown-Forman and the Brown family in 2012 helps to promote a more sustainable whiskey industry with a focus on the 3 natural resources most important for the distillation and aging of whiskeys: wood, water and grain. As you know, at Brown-Forman, we take an integrated approach to value creation, where all aspects of our company contribute to and are fundamental to our strategy, including our commitment to environmental sustainability, alcohol and marketing responsibility, diversity and inclusion and contributing to the vitality of the communities in which we live and work. These investments are just 2 examples of how we are living our spirit of commitment.

In summary, we are adjusting to more normalized levels of consumer demand and a challenging and dynamic operating environment. As we look to the end of fiscal 2024, we believe that we have moved beyond the most difficult comparisons and disruptions of our fiscal year and will benefit from our long-term strategies as well as our portfolio evolution. We believe our portfolio of brands is strong as they are participating in growing categories and price segments and are driven by the consumer trends of premiumization and the desire for convenience and flavor.

While we have more modest near-term expectations, we believe our long-term perspective will enable us to navigate the current environment and its short-term impacts as we have many times since our founding in 1870 and to deliver consistent and reliable performance and returns over the long term. We look forward to seeing many of you in-person soon and sharing more about the confidence we have in our long-term ambitions at our Investor Day on March 20. This concludes our prepared remarks. Please open the line for questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from Lauren Lieberman with Barclays.

Lauren Lieberman

Great. So I'm still, honestly, to all the prepared remarks, a bit confused around where the shortfall really stemmed from both in the quarter and stemming going into Q4? Because you talked about sequential improvement in the second half with what was expected. Third quarter looks like it decelerated sequentially despite the easier comp. I know you mentioned softer holiday demand globally, but again, that doesn't really help me with the 4Q. So just if you could maybe rank order what sort of where the areas were of short-term negative surprise, I think that would be really helpful.

Leanne Cunningham

Thanks, Lauren. And I'll go ahead and I'll step back a little bit broader first, and then I'll narrow and specifically to your question. So first, let me say, we think about our business in decades and generations, and I'd like to point you to Slide 5, which when we think about the 2020 decade that we're in and the kind of the first 3 full fiscal years, you can see that our compounded annual growth rate for that period of time on an organic net sales basis is at 9%, which is definitely above our long-term growth algorithm. And then kind of moving closer into the period that we're in now, we have now lapped the first half of F '23, which was our strongest first half growth rate in the last decade. We talked about that in our last call and that was all about rebuilding our inventories.

And then if you kind of look at last year, kind of 9 months year-to-date and this year, that CAGR is 6%, which is in line with our longer-term growth algorithm. So when we step back and look at it at the broadest perspective, so far for this decade, we believe we're off to a good start, and we have confidence that our business is sound with a strong gross margin expansion and strong cash flow. So just to set the stage and then I'll dial in even closer to your question is, you're right in this what we said is during the important holiday selling season, we did not expect the softness of consumer trends that we did see during that important holiday selling season, and that has now limited our top line acceleration.

When we think about it from a market perspective, for us, it was U.S. and the key developed markets of the U.K. and France. And I'm sure in this call, we'll talk a lot about the U.S. But while we're here, I'll talk about the U.K., which we know the U.K. part of it is about our transition to of the Jack Daniel's and Cola to the Jack Daniel's on Coca-Cola business, but we really did see a slowing consumer and a very strong promotional environment during the holiday selling season. And then in France, we saw the slowing consumer trend, even kind of declining more than what we expected with the softness in the whiskey category and definitely some trading down in that market.

And then what I would say then kind of the rest of that piece is the slowdown across many of our emerging international markets, which was just more than what we had expected in our guidance. One thing I can say is you can see in Schedule D – or sorry, Schedule B that when we reported last time, our shipments and depletions for our full strength portfolio were in line. We now see where we are year-to-date that our depletions are ahead of shipments. So again, that's another signal that we believe that we are kind of moving beyond what we have had to lap. But then as we talk about kind of to your point with the last quarter, like we shared in our last call, when we think about the second half, we know we have to lap, the launch of Jack Daniel's and Coca-Cola RTD in the U.S. But when you look at kind of the – the half as a whole, we have to comp of plus 5%.

And where we believe we're going to be able to do that is, again, with the contribution of our newly acquired brands of Gin Mare and Diplomatico. We're continuing to see benefits from pricing and revenue growth management, which is kind of equating to that strong gross margin expansion that you have seen in our results. And then again, our operating expenses increase. That remains the same, where we had phasing where our brand expense was greater in the first part of the year, we now – that will moderate through the rest of this year. And SG&A expenses, that's related to the higher compensation and benefits-related expenses as well as our increased expenses for the own distribution investment that we're making in Japan that's set to go live on April 1. So that is all built into our guidance.

Lawson Whiting

Let me give you a shorter version, Lauren. Christmas stunk around the world for the – I mean we had a lot of markets that disappointed during Christmas this year, which we did not expect when we were thinking about our year-to-go period 3 months ago. So it was surprisingly weak.

Lauren Lieberman

Okay. Then just one quick follow-up because that was a very full-some answer. Both versions. The short and long. But what does that mean for inventory levels in Q4? Because I know, Leanne, you called out the shifts versus depletes in that like the big picture laps are getting to a better – we're moving along. But shipments – like shipments were also weak for Christmas, right? I'm just trying to put the two pieces together because if you expected Christmas do better, usually the shipments have kind of happened, right? And it's the depletions of the problem. So that's also a little bit surprising to me if I'm making sense. I would expect it to be shipments might have been okay, but depletions would have been the problem and that would be the hangover for Q4.

Leanne Cunningham

Yes. I think what we saw was we didn't see those orders come in for the important holiday selling season like we – at the level that we traditionally do and being able to comp above where we were. So that didn't come in the way that we expected again in that late November, December time frame that we were expecting. And so when we think about it, again, we continue to be in a bit of a different position, which we've talked about this many times as we rebuilt our inventory. We continue to believe that our inventories through the supplier to the distributor, to the retailers, consumer are in line.

And really, this is about consumer takeaway at this point for us. And so again, we're –

that fluctuation in consumer takeaway being lower than what we expect to really drove that for us. We do continue to see when we'll go to the U.S. specifically, you continue to see that net change in distributor inventory kind of come back in line if you look from the first half to the third to the 9 months ended, that is coming much more back in line, which we said we expected it to moderate.

Operator

One moment for questions. Our next question comes from Bonnie Herzog with Goldman Sachs.

Bonnie Herzog

I actually just maybe have a bit of a follow-on on the conversation you guys were just having. Regarding inventory levels, but more at the consumer I guess, level. Do you have a sense of where these are and really how much you think consumer pantry destocking is impacting the category? And then your thoughts on when that might reverse? And Lawson, do you still believe the category growth will get back to the mid-single-digit range? And then if so, how quickly could this occur?

Lawson Whiting

Yes. Okay, Bonnie, it's a good question because we have – we have talked a lot about that internally over the last few weeks around – I'm talking about the consumer inventory thing. And I do think, and I believe, although it is – that's a hard number to get to. There's really no way to study consumer inventories necessarily what's still in the pantry.

But my theory, if you look at the last 3, 4, 5 years, you can see the elevated growth rates. Leanne was just quoting a few of them. But let's just focus on the 3-year because it's on that Page 5 of our – you're looking at a 9% organic growth rate over 3 years, including this year. That is way – several points above any sort of normal run rate for the most part in our industry. Some of that has to be sitting in a consumer's pantry at home.

Now people think of Spirits is often referred to as a fast-moving consumer good and it's really not. It's not like food or some other categories that move much faster. Spirits, I call it kind of in the middle when I think about different consumer categories, I think about food being the fastest, I think, about – an exercise bike is the slowest because once you pull that demand forward, you're not going to go buy another bike. Spirits is in the middle. And so it is taking some time to clear those consumer cabinets.

We've said before that we look at like 80% of our consumer base only buys 2 bottles a year. So they have a bottle sitting in their cabinet at home that's probably half full, and it's just the deferred cost. The good thing is we think that if you do the math around that, that should largely be over. And that's why Leanne just said here, we expect going forward particularly in the U.S., I think we're talking, but our sales rates to be much closer to what consumer takeaway is right now.

That's question one. What's the other? It was – oh yeah – when do we get – yes. TDS getting back to norm of 4% to 5%, which is what it has been for like decades, short of the last couple of years and all the volatility. I know I've seen some of our competitors that have said anywhere from 6 to 18 months, and that's a pretty big – that's a pretty big range. I think for us is what we're saying, we do believe next year will start to return to those normal levels as this inventory conversation largely, we think, will largely be over.

Operator

One moment for questions. Our next question comes from Andrea Teixeira with JPMorgan, you may proceed.

Drew Levine

This is Drew Levine on for Andrea. So just following up on the U.S. You talked about some changes in consumer behavior internationally in France. I think you're seeing some trade down. Can you talk about what you're seeing in the U.S. any items of perhaps more valueseeking challenges or trade down? And then also what you're seeing from an on-premise perspective, if there's been any incremental softness there?

Lawson Whiting

Yes. So look, I mean, on the trade down – this is the U.S. And I think this is good news, I think, relative to probably what people are expecting. But if you look at the data, particularly I'm looking at Nielsen data, over the last 3 months, you're not seeing trade down. And we've still got the same dynamic where I'll simplify a little bit here, but $30 and above is growing much – and take RTDs aside to pull that out of that when I say this, but 30 and above is growing at a materially better number than 30 and below. And so that's just – we're not seeing the trade down in our own portfolio, and we're not really seeing it across the industry yet. So I think that just hasn't happened.

And that – I think we were expecting to see maybe a little bit more of that. So I generally consider that good news. And on the pricing environment, which you didn't specifically ask about that, but I think it's worth talking about that for a second because pricing really has not – we've been worried as you've seen, consumer weakness, but somehow that would result in more aggressive pricing, deeper pricing to Christmas, all those kind of things. And it didn't really happen. And we're not really seeing that coming through the data right now. If you look at TDS across spirits, it's still positive, like plus 1 or 1.5, something right in there.

And interestingly, this is where we were narrowing down even quicker is tequila in the U.S. and then U.S. whiskey across the U.S. and both are also positive. So there's been a lot of speculation that tequila pricing would start to fall apart as the costs have come down. It's just not showing. And if you look at the last 13 weeks, and you go – which would cover the Christmas time period, both those categories saw improved pricing, not lower. And so while I do hear a lot of these anecdotal stories of XYZ brand went deep or whatever it might have been, and there are examples out there like that. But for the most part, pricing is holding up so far, and I consider that to be a pretty big positive too.

Leanne Cunningham

On premise?

Lawson Whiting

On-premise. Do you have – don't have the on-premise number in front of me. Sorry, we don't – I don't have the on-premise numbers right in front of me. So I don't – I haven't seen a material change in those necessarily. But trying to find the data point. Let's get back to you on the on-premise one.

Leanne Cunningham

This is where we talked about that there's 2 points of acceleration compared to the October 23. So we continue to see acceleration there with TDS and Brown-Forman now growing low single digits.

Operator

One moment for questions. Our next question comes from Chris Pitcher with Redburn Atlantic.

Chris Pitcher

Just a question in terms of buying patterns. You sort of alluded to it. But in the current environment, have you seen any structural changes in how retailers or wholesalers are buying in given the sort of the interest rate environment and the uncertainty. Is that creating making it harder for you guys to plan? And then if I can have a follow-up, just on Japan, you flagged that as being one of the areas that got hit hard by destocking. With sales down 100%, it's quite hard to gauge what the real underlying revenue is with your new route to market there. Could you give us an idea of what sort of scale the Japanese business is still running at despite all these massive distortions?

Leanne Cunningham

Yes. So I'll go back to the first part of your question, which is as far as buying patterns, we shared with you, I think, in our last call that as how we prioritize rebuilding the markets that we have with – and replenishing their distributor and retailer inventory. That kind of has changed in the short term, our traditional consistent seasonality of the shipments that we – pattern buying that we have seen. We're still lapping some of that, especially as you get into our emerging international markets, and we're lapping the way that we rebuilt that and the timing and the cadence is a little bit different. It makes – it does make it a little bit harder. But I think for us, the biggest piece again was back to that important holiday selling season and consumers being stretching their discretionary spend because of how they've been impacted with interest rates and inflation.

And for Japan, when we look at that business, again, this has been a year of kind of two pieces. One was how we've rebuilt our inventory in the prior year. And I think we said in our prepared remarks, we had a backlog of orders waiting for supply to be able to fill those we were able to do that in the second half of last year. So coupling that with our route-to-consumer change, it has just basically – we haven't needed to make any shipments to Japan this year.

To your point, what's the business look like more on a depletion base. And we would say we have been in frequent connection with the team there as they continue to progress to this own distribution model on April 1.

And from a depletion base, we are still excited about the health of our brands in that market. So again, I would say from an organic perspective, we just have – we're investing in the long-term value creation opportunity in Japan, and it's set to be a growth driver as we're moving forward.

Chris Pitcher

Just quick – normally, a company – a country, a market would drop out if it's not in the top 10 in a period. Can we assume the fact that you've still put Japan in there that it would be a top 10 market for you on a normalized basis?

Leanne Cunningham

Yes. How we set our top 10, and I think we have it in our Q, it's basically set on April 30 of our prior year. So it's in there for that reason.

Operator

Our next question comes from Nadine Sarwat with Bernstein.

Nadine Sarwat

Two for me. First, just a clarifying question. You had mentioned your view that perhaps the market in the U.S. could get back to that historical 4% to 5% value growth in the next year. Could I just clarify with that fiscal next year or calendar next year? And then my second question is something I think a lot of people are bringing up amongst investors, the topic of moderation, perhaps younger consumers drinking less adding some GLP-1s in there. I mean all of this has been thrown around as potential reason for the weakness that we're seeing in U.S. spirits. But to be honest, in U.S. alcohol more broadly with the implication that, that could be a permanent change. I would be curious to get your views on that, those – all those factors I listed and where do you think it goes from here?

Lawson Whiting

Yes. Good. So Nadine, a few things on this because it's obviously a topic that we have spent a lot of time trying to understand a little bit better, too. If over the last – I'll make it up, 5 years, we had seen TDS go from 5% to 4% to 3% to 2% to 1%, something like that. I would be concerned with some of those things you just talked about, wellness trends, cannabis trends, GLP-1s, all those types of things, that would be an indicator that something is happening structurally in the business that's going to – that could be permanent. But that's not what we saw. We – as I think everyone on this call knows, I mean that 4% to 5% range with COVID moved it around volatility-wise, but it has been in that range for decades.

And then all of a sudden, we know – if you look at TDS, the same – you look at July of last summer, and you see a very sharp deceleration in the market like GLP-1s or cannabis is not going to take a market and move it 4 or 5 points seemingly overnight. And so I just don't think that's what is – I don't think those big macro concerns that are out there are what is impacting the market today. Now over the next decade or 2, do I want to look at that and understand that better. It is – it could be a headwind, yes. But particularly on a healthier Gen Z kind of conversation.

Cannabis, that's been around now for – I don't even know, 10-plus years, whatever it is. We studied that 18 ways until Sunday and have never been able to find a state where we saw reduced alcohol consumption based on going legal, and it's tough to do now because so many places are legal. But – so yes, so I do think, in general, these are shorter-term challenges, particularly the U.S., but it's also true in Europe to Europe is feeling a lot of the same macro factors in the U.S. is. And I do think that it's the combination of what we've already talked about, but the very difficult comps.

I think the consumer is weaker than it was, say, this time last year. But now predicting is the turnaround going to be 6 months or 12 months, I don't know. I don't have a crystal ball on that. But I am a believer that the macro factors impacting our business are more short term in nature than these big macro headwinds.

Nadine Sarwat

Got it. And just to confirm that getting back to 4% to 5% next year comment with that next year fiscal or calendar?

Lawson Whiting

I don't know if I was kind of – I'm not making it up, but I mean it's more of a return to normal over the next, call it, 12 to 24 months in our world, something like that.

Leanne Cunningham

Yes. And then the one thing that we looked at is in history is not always a predictor of the future for many reasons we know. When we went and looked back at the last time the consumer was really stretched with macroeconomic factors we looked at 2000, 2001, 2008, 2009. And they were followed by really strong years of growth. And those trends were when they were negatively impacted were much shorter, unlike Lawson just said, it's kind of the 12- to 18-month window by which we're already in it. So none of us know, but that's what history has said to us.

Operator

One moment for questions. Our next question comes from Eric Serotta with Morgan Stanley.

Eric Serotta

First of all, I'm hoping you could expand upon your comments earlier on pricing and promotions. First, I guess, as a housekeeping item, when did your pricing in the U.S. particularly on Jack Daniel's go in? And then I know you said that the – those are not seeing much pricing in the data, but it does seem like it's more than kind of one-off anecdotal or the anecdotal reports about discounting seem to be more than one off. I know Diageo mentioned some increased promotions in the U.S. Just wondering if you have any broader perspective between what seems to be a broader theme of increased promotions and what you guys are seeing in the data.

Lawson Whiting

Yes. Well, on the – pricing history, I guess, when did it kick in? It was if we're talking about the U.S., it was about 3 years ago now. So we have chosen, I think, a slightly different path than some of our competitors. We've talked about this numerous times, but it's kind of that low and slow. And it's what I want to see continuing going forward and is what we're trying to strive in even over the next 12 or 24 months. And that's a U.S. comment for the most part, but it actually does apply to much of the rest of the world, too. Europe has had pretty healthy price increases in the last couple of years, too, which is collectively why we – one of the main reasons why we've been able to improve our gross margin. And so I have very little interest in giving that back. And so we're going to continue to be pretty strong with that.

As I mentioned earlier, I mean, I know anecdotally, it feels that way, and I've heard the same things, and I saw what some of our competitors have said. But the reality is it's not coming through the data. So I don't know sure how else to answer that. I mean we talked about trade down earlier, a couple of questions ago or the lack of, I should say. So it's not coming through and trade down the year, and we're not seeing it in terms of really individual brands that have all of a sudden gone deep. And by the way, I think it's worth probably commenting to, and this is a very high level. So I have personally – we're not deep studying this quite yet. But the competitive some of the brands that have gone lower haven't seen much in the way of a decent rebound in their volume.

I'm just not sure these – I'm not sure that's the core consumer problem right now is higher pricing. Pricing elasticity are, as I said, low and slow, but if you compare pricing changes over the last 2, 3 years to what grocery has done to what other consumer categories have done where it was much more – you saw much higher inflation in the food channel, let's say, than you did in spirits. And so I just – I don't think – I'm not that worried that our pricing actions have chased consumers away from our products. I just don't – I think that will be sort of missing what the actual problem is.

Eric Serotta

Great. And then just one other question. I'm hoping to get your perspective on either Brown-Forman or industry barrel whiskey inventories obviously been a massive investment cycle over the past decade, making up for the previous for 4 decades. But maybe, hopefully, you could give some comments as to where you think inventories are today relative to future demand, realizing you've got a plan for multi-decade cycles here?

Leanne Cunningham

Yes. So I'll talk about our barrel whiskey inventory. And I think for anybody who's followed us for a while, you've probably heard us say that we have a very robust semiannual process where we're always adjusting to future consumer demand outlook. And with doing that, we capture the change in trends if there are any. So when you look at our barrel whiskey, we're constantly adjusting it. When you look at our balance sheet, when you see increases for us there. It is about looking out over the long term, and that represents our future growth expectations.

And you probably – with work in process, also in some brands, you would find our aging inventories there. And we – with the acquisition of Diplomatico you would have seen that increase as well. So for many in the industry. I don't want to speak on anybody's behalf but many in the industry use not the same proprietary way of doing the work, but I know that they often look at their long-term demand over that cycle as well. So I think people are always adjusting.

Operator

One moment for questions. Our next question comes from Peter Grom with UBS. You may proceed.

Peter Grom

Thanks, operator, and good morning, everyone. Hope you're doing well. So I guess I'm a bit confused by the commentary on the top line trajectory. So on one hand, you're talking about a normalization of category growth. And you'd expect that to get back to that mid-single-digit growth at some point over the next 12 to 18 months. And that would kind of seem to imply that '25 could be another challenging year. But on the other hand, if you back out the distributor inventory headwind, which sounds like you expect to be largely complete after 4Q. You're kind of already at this mid-single-digit growth rate. So I know we'll get to fiscal '25 in June. But how should we think about the building blocks for your organic growth outlook for over the next 12 to 18 months. Should we focus more on that category growth rate? Or should we be kind of focusing on kind of lapping this distributor inventory headwinds?

Leanne Cunningham

Yes. So as excited as we are to begin to talk about our next fiscal year, we'll have that in full detail for you in our next call.

Lawson Whiting

But I do think you picked up on an important point. If you look at that depletion schedule or Schedule D, if you assume that we're there from an inventory perspective, certainly, depletions are better than certainly a lot better than shipments over this year. So we're getting there. We're getting capacities comps. I mean there's like light at the end of the tunnel. We can't get there fast enough, but we're almost there.

Peter Grom

Okay. That's helpful. And then maybe just a quick follow-up on gross margin. I know a lot of moving pieces here, and Lawson, I appreciate the commentary on the year-to-date progress. But from a quarterly perspective, you would have to really go back to kind of the tariff date to see a sequential step down of this magnitude in the third quarter relative to the second quarter. Was that simply a function of a weaker volume performance? Or was there something else that drove that kind of sequential step down?

Leanne Cunningham

Yes. So when we think about our gross margin and the outlook that we have driven by a couple of things. So one, we lapped supply chain disruption. And largely speaking, we had the majority of the cost in our second quarter of last year. So that benefit continues to moderate as we move through the rest of the year. And then just as we do kind of estimates from an inventory costing perspective, we would have had a benefit in our fourth quarter of last year that we will have to comp this year. But all of that has been built into our full year guidance for the entire year where you've been able to see kind of the difference between our top line growth estimates and our operating income and the leverage that we've expected through there.

But we have been very happy to return to gross margin expansion and have the strong expansion that we've had through the 9 months to date. But again, talking about in that last quarter, it will go more towards the guidance that we have provided.

Operator

One moment for questions. Our next question comes from Filippo Falorni with Citi.

Filippo Falorni

I have a question on the ready-to-drink spirits part of the category, particularly in the U.S. If you look at total Spirits categories stripping out, ready to drink actually, the trends have been a lot more negative than it looks on the surface. So do you think this growth in the ready-to-drink spirits is more structural? And have you done any work of calculating any impact on your volumes given, obviously, you sell less liquid in registered drink compared to like a full bottle if that were to continue to grow at this rate? And following up on the margin part, you talked in the past about ready-to-drink spirits being more of gross margin dilutive, although more similar at the operating margin level. So any thought on the margin implications would be helpful.

Lawson Whiting

Well, your first part of that was the TDS. And yes, you're right, RTDs are boosting TDS for sure. You take those out and it's closer to flat, which honestly is close to flat – it's been 30-plus years since TDS has gone negative in the United States, not since the early 1990s when they had the excise tax changes. So from a pure TDS takeaway U.S. figure, it's about as bad as it's been what it is as bad as it's been in my career. So there are certainly challenges there.

Now do I think there's this big structural move in the world of RTDs. One, I mean, they meet a lot of consumer trends and needs right now. So I do believe it's a very powerful category. But if you go back over the last 20 or 30 years, and you look through our industry, there have been so many booms and busts of different brands that we always start out by talking about California Cooler 30 years at Brown-Forman – 30 years ago on it went from 12 million cases to 0 in about 2 years.

So I mean there are booms and busts in that space. Jack & Cola is a little part – Jack & Coke is a bit different in that it's such an established strength already. It's the largest bar crawl in the world. That is not a [fact] in my mind. There are other brands we'll see. We've seen what happened to the mall-based RTDs over the last few years and that category got blown up largely by the spirit-based RTDs. So it's – it's a volatile space for sure.

Leanne Cunningham

And then to your – the liquid part and the margin part of your question, from liquid, yes, there is less liquid in the case of RTDs, of course, then the full strength but we will be planning to supply liquid to significantly broader geographic reach with this product. Again, and we just talked about the process that we use and looking for the demand needed for liquid. So that would be built into there.

And then from a margin perspective, though, gross margins for RTDs are lower than our company average. Jack & Coke should be higher than the rest of our RTD portfolio because we will have advertising support jointly funded between Brown-Forman and the Coca-Cola Company. And we have to look at it in totality of when we're increasing our RTD business that we're also adding in the two super and ultra-premium brands of Gin Mare and Diplomatico, which have higher gross margins than the company. So you'll have to take all of those factors into account.

Operator

Thank you. I would now like to turn the call back over to Sue Perram for any closing remarks.

Susanne Perram

Thank you. And thank you, Lawson and Leanne, and thank you to everyone for joining us today for Brown-Forman's Third Quarter and Year-to-Date fiscal 2024 Earnings Call. If you have any additional questions, please contact us. We look forward to seeing many of you in Louisville on Wednesday, March 20, for our 2024 Investor Day. Presentations by the company's executive leaders will focus on Brown-Forman's strategic priorities and long-term ambitions. Details regarding the live webcast of the presentation along with a question-and-answer session can be found in the March 4 press release about the event. And with that, this concludes today's call.

Operator

Thank you for your participation. You may now disconnect.