Brown-Forman Corporation, Q2 2023, Earnings Call 2022-12-07

Presentation

Operator

Hello. Thank you for standing by, and welcome to the Brown-Forman Corporation Second Quarter and First Half of Fiscal 2023 Earnings Call. — ***Operator Instructions*** — Please be advised that today's conference may be recorded.

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

Susanne Perram

Thank you, and good morning, everyone. I would like to thank each of you for joining us today for Brown-Forman's Second Quarter and First Half of Fiscal 2023 Earnings Call.

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

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

This morning, we issued a press release containing our results for the second quarter and first half of fiscal 2023 in addition to posting presentation materials that Lawson and

Leanne will walk through momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations.

In the press release, we have listed a number of the risk factors you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K and Form 10-Q reports filed with the Securities and Exchange Commission.

During this call, we will be discussing certain non-GAAP financial measures. These measures are 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 conditions 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

Well, thank you, Sue, and good morning, everyone. I'm pleased to share our results with you today as we had a strong first half for fiscal '23. We delivered double-digit top line growth on both a reported and organic basis. This performance was led by the strength of our portfolio of brands, which continued to benefit from strong consumer demand. We also benefited from the rebuilding of distributor inventories, which continued to recover as supply chain disruptions and constraints eased, particularly for glass.

The recovery, though, has added additional costs as overall supply chain logistics and transportation continue to be constrained, and we proactively took actions to satisfy the demand from our distributors and retailers ahead of the important holiday season. These costs, along with inflationary increases and the negative effect of foreign exchange more than offset the positive impact gained from favorable price mix and the removal of the

EU and U.K. tariffs on American whiskey. The result was gross margin contraction, though during the first half.

Now let me provide a few additional details on the first half. Our reported top line growth increased 11% with organic growth increasing 17% after adjusting for foreign exchange headwinds. Organic net sales growth in the first half was driven by continued strong growth for Jack Daniel's Tennessee Whiskey across all geographic clusters in the travel retail channel, Woodford Reserve in the U.S., Jack Daniel's RTDs in Australia and Germany, along with New Mix in Mexico, and Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Fire in the United States.

Jack Daniel's Tennessee Whiskey was the largest driver of our top line performance, delivering double-digit growth with an organic net sales increase of 18%. The growth was driven by strong consumer demand, higher pricing and favorable channel mix.

Our super-premium American whiskey portfolio also increased organic net sales by double digits. Woodford Reserve and Old Forester grew organic net sales 40% and 39%, respectively.

Despite supply chain – supply constraints in the prior year, consumer demand for Woodford Reserve remained strong, and we were better able to meet this demand as glass supply challenges eased, and we increased our bottling capacity.

The consumer trends of convenience and flavors continue to fuel double-digit growth of our RTDs, which were the third largest contributor to overall company growth. Jack Daniel's RTDs grew organic net sales 15%, and New Mix delivered 46% organic net sales growth. Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Fire also benefited from the same consumer trends as well as improved glass supply. Both brands grew organic net sales double digits, 12% and 28%, respectively.

I also wanted to mention our full-strength tequila portfolio. As we shared last quarter, Herradura experienced significant challenges during the first 3 months of fiscal ’23 due to supply chain disruption, mainly related to glass. Fortunately, glass supply increased through the end of the first half, enabling us to better meet demand and deliver a 9% increase in organic net sales for Herradura. Organic net sales for el Jimador increased 18%, driven by higher volumes in the United States.

So now turning to gross profit. In the first half of fiscal ’23, our reported gross profit increased 8% or 17% on an organic basis. We continue to focus on an overall strategy to increase prices more consistently year after year and benefited from 240 basis points of favorable price mix in the first half.

Based on Nielsen data, Brown-Forman remains one of the pricing leaders in the U.S. with nearly 3% pricing growth outpacing total distilled spirits growth of just over 2%. This continued emphasis on identifying pricing opportunities, not just in the U.S. but also internationally, is a key part of our focus on revenue growth management. These efforts span across multiple spectrums, including mix such as channel, pack and customer, promotional strategy and efficiency, trade terms and distributor margins and, of course, pricing.

However, gross margin headwinds more than offset these pricing actions, resulting in 130 basis points of gross margin contraction. Supply chain transportation and logistics costs and constraints remain challenging, and we took proactive steps to ensure our products would be on the shelf ahead of the important holiday season. We believe these decisions supported our top line growth, ensured we met the strong consumer demand for our brands and allowed us to continue to implement our long-term pricing strategy.

With our long-term perspective, we have the opportunity to continue to invest in the momentum of our brands and ensure we’re developing and driving the next generation of growth. Over the last 2 decades, we’ve transformed our portfolio to focus on premium and super-premium brands. We've sold our consumer durables business, the majority of our wines as well as standard brands in slower-growth categories.

We acquired much more premium brands like Casa Herradura, our 3 Single Malt Scotches, Slane Irish whiskey and Fords Gin. We continued efforts to premiumize our portfolio through the first half of fiscal '23 and with several new acquisitions and new strategic relationships.

First, we're very excited to welcome Gin Mare, a fast-growing ultra-premium gin and its recent line extension, Gin Mare Capri. Gin Mare is the world's #1 ultra-premium gin according to the most recent IWSR data and is sold in more than 70 countries. With the majority of sales in Europe, Gin Mare is the largest – Gin Mare's largest market is Italy, followed by Germany, Spain and the travel retail channel. The brand will be a strong addition to our emerging brands portfolio, particularly in Europe, where its scale will be beneficial as we continue to build and expand a focused emerging brand sales group.

We believe Gin Mare, at over 200,000 9-liter cases, has strong positioning and is complementary to Fords Gin and our broader super premium portfolio, and we're delighted is now part of the Brown-Forman family.

We're also looking forward to entering the rum category with Diplomatico Rum. Based on IWSR 2021 data, the super premium plus rum category has grown at an annual rate of 17% over the last 5 years, and Diplomatico was the #1 super-premium and ultra-premium rum.

Diplomatico has a strong brand heritage, has reached significant scale in attractive geographies, it's growing quickly and has a strong margin profile. Similar to Gin Mare, the brand has a strong European presence, aligning well with our investment in owned distribution in markets such as France and Germany, which are Diplomatico's top 2 markets.

It, too, will be part of our emerging brands portfolio in Europe as well as in the United States, which is the brand's third largest market.

When considering the expansion of our portfolio, we look for acquisitions and partnerships that enhance our ability to deliver meaningful growth, improve key financial metrics and increase shareholder returns. We believe Gin Mare and Diplomatico Rum are well positioned to accomplish all 3 of these objectives. And with the addition of these 2 brands, Brown-Forman now owns 1 of the top 5 super premium plus brands globally and 4 strong growth categories, U.S. whiskey, tequila, gin and rum.

In addition to these acquisitions, we're developing significant relationships that we believe can propel our growth. Our recently announced global agreement with the Coca-Cola Company to deliver the iconic Jack & Coke cocktail as a branded ready-to-drink adult beverage is an exciting play in an attractive category. The opportunity for the Jack Daniel's and Coca-Cola RTD is significant, and we believe this will meaningfully expand the growth of both of our businesses.

With the successful launch of the Jack Daniel's and Coca-Cola RTD in November in Mexico, I want to thank the teams of Brown-Forman and Coca-Cola who worked to make the product launch a reality.

I would also like to take a moment to share a bit more about the significant opportunities we see within the RTD category. Based on IWSR 2021, the RTD category is a $39 billion business globally and is projected to grow in the high single digits with the Cocktail and long drink segment projected to grow even faster, delivering double-digit growth over the next 5 years.

We believe RTD cocktails address a distinct consumer occasion. And based on our results, we've not seen the growth of our RTD cocktails result in a decrease in our full strength products. In fact, we've experienced growth of both of our full strength in RTD products side by side, proving to be a net benefit. Jack Daniel's existing RTD products hold approximately share a 2.5% share of the global RTDs business and approximately 9% share of the cocktails and long drink segment.

We believe there are numerous opportunities for geographic expansion and to gain share. Based on IWSR 2021, our current Jack Daniel's RTDs products have approximately 25% of the global and Cola business concentrated largely in 2 markets, Australia and Germany. That's a lot of runway for us to expand geographically. And of course, Coca-Cola is a wonderful company to work with because of the global reach of their bottling network and the strength of our iconic brands standing together beside ours.

We look forward to expanding in a number of key markets around the world in the first half of calendar 2023, including the large RTD markets of the U.S. and U.K. as well as additional selected European, Asian and Latin American markets, and I look forward to sharing more as these markets launch in the upcoming quarters.

In addition to our relationship with Coca-Cola, in September, we announced a new multi-year global partnership making Jack Daniel's an official global sponsor of McLaren Racing, taking our iconic Tennessee Whiskey brand to the fastest-growing sport in the world, Formula One. Our partnership begins officially on January 1 for the 2023 racing season.

Appeal for Formula One continues to grow at the fastest rate of any major global sport with more than 1 billion fans and viewership that regularly exceeds that of the National Basketball Association, the NFL, the Premier League and the Champions League. The majority of the sports growth comes from the next generation of fans, providing a powerful opportunity to reach new consumers of legal drinking age and expand Jack Daniel's relevance in pop culture.

Identifying the right partner in this space was of paramount importance, and we believe we have found that in McLaren Racing. Our globally iconic brands share common values and commitments to responsibility and sustainability. This partnership is an important and high-profile global platform to promote responsible consumption and directly combat drunk driving. Jack Daniel's has a long track record of promoting responsible consumption of our products, and our responsibility message appears in all of our communications and promotional materials.

We believe the new partnership with McLaren Racing and Formula One creates an exciting opportunity for Jack Daniel's to live boldly at every turn engaging a truly global fan base with races on most continents around the world.

In summary, we had a strong first half of fiscal '23 and continue to invest boldly behind our brands, our people and our long-term growth. The global macroeconomic and geopolitical environment remains volatile and uncertain yet we remain optimistic and confident as we look ahead.

At the heart is our performance ambition that is there will be nothing better in the market than Brown-Forman. This promise was on the very first bottles of Old Forester signed by George Garvin Brown, and it remains our pledge today across all aspects of our business. We often describe this ambition, not as a goal or a destination, but a way of thinking, a way of working and a way of making decisions. We have faced numerous economic, political and environmental challenges over the past 15 decades and it thrives because we have the agility and resilience to adapt and seize opportunities. We're 152-year-old company with a focused, yet agile strategy and a clear ambition, nothing better in the market.

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

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. As Lawson reviewed our headlines for the first half of fiscal 2023, I will provide additional details on our business results and our outlook for the full year. First, I will share our top line results by geography for the first 6 months of fiscal 2023. The strong results were broad-based with each geographic cluster achieving double-digit organic net sales growth compared to the same period a year ago.

The U.S. business accelerated through the first half, delivering organic net sales growth of 11%. This performance was driven by an estimated net increase in distributor inventories, price increases across the portfolio of brands, continued premiumization along with positive size and channel mix as well as innovation. Woodford Reserve was the largest contributor to organic net sales growth in the first half, with the positive impact from higher pricing and higher volumes as glass supply and capacity constraints eased, supporting our ability to better meet the strong consumer demand.

The Jack Daniel's family of brands also contributed to the increase, led by volume growth from Jack Daniel's Tennessee Whiskey. In addition, Jack Daniel's Tennessee Fire, Jack Daniel's Tennessee Honey and Gentleman Jack experienced volumetric gains as they benefited from an improved supply chain environment. The newest members of the Jack Daniel's family, Jack Daniel's Bonded Tennessee Whiskey and Jack Daniel's Triple Mash Whiskey are the first 2 permanent super-premium expressions in almost a 1/4 of a century.

These brands are off to a strong start as they continue to gain distribution and have been awarded multiple gold medals for taste and global spirits competition. Korbel California Champagne partially offset the growth of the rest of the portfolio. The sparkling wine category experienced significant growth during the pandemic, and the trends are beginning to normalize. The brand is benefiting from higher pricing, but that benefit is being more than offset by lower volume.

Off-premise takeaway trends continue to be impacted by the shift to the on-premise as consumers have made the gradual return to restaurants and bars, though trends are beginning to normalize. We see this in consumer mobility data, which has continued to hover around pre-pandemic levels. This channel shift along with account mix and supply chain impact are the main drivers of the difference between takeaway data and our actual results. As we have mentioned, we continue to work to rebuild finished goods inventory levels across the 3-tiered system, though we still believe distributor inventory levels remain below their pre-pandemic levels as consumer demand remains strong and transportation and logistics constraints persist.

Collectively, our emerging international markets continued to deliver very strong double-digit organic net sales growth, increasing 27% driven by Jack Daniel's Tennessee Whiskey particularly in Turkey, Brazil, Sub-Sahara Africa and Poland. And RTDs, which had a strong performance with Jack Daniel's RTDs and New Mix growing strong double digits in Mexico, where we are gaining share in a growing category.

This growth was partially offset by year-over-year declines in Russia due to the suspension of our commercial operations beginning in March of 2022. Developed international markets collectively delivered strong organic net sales growth, up double digits for the first half of the fiscal year, building on the double-digit growth in the same prior year period. While the inflationary environment is impacting consumer confidence, we have not observed signs of down trading and have been able to continue to increase price through our revenue growth management strategies.

Jack Daniel's Tennessee Whiskey was the largest contributor to growth driven by Germany, where Jack Daniel's is gaining share within total spirits and the whiskey category. Spain, which is benefiting from the return of tourism and Korea as consumers shift to international whiskey brands. Momentum continued for Jack Daniel's RTDs with double-digit organic net sales growth led by Australia and Germany.

Consumers' desire for convenience continues to propel interest in the RTD category in these markets, and we gained share. el Jimador, Woodford Reserve and GlenDronach, each delivered very strong double-digit organic net sales growth, driven by our emerging brands model which supports our strategic priority of increasing focus on our premium and super-premium portfolio.

Route-to-market models play an important role, not only for our super premium portfolio, but also our core portfolio. Owned distribution can fuel share growth, strengthen our position, unlock future potential and enable us to capture more of the value chain just to name a few of the impacts.

Since transitioning to own distribution at the beginning of this calendar year, Belgium has more than doubled its organic net sales compared to the same period last year.

Finally, the travel retail channel, continuing its strong rebound, growing organic net sales 67% led by higher volumes across much of our portfolio as travel continued to rebound with the return of international airline travel and the cruise industry. Our business in this channel is quickly recovering and is close to returning to pre-COVID levels.

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

Our organic SG&A investment increased double digits, driven primarily by higher compensationrelated expenses and the investment behind our people as we are gradually returning to in-person events and activities in support of our collaborative culture and relationship-based industry. In total, reported and organic operating income grew 8% and 19%, respectively, in the first half of fiscal 2023. These results, combined with a decrease in our effective tax rate, resulted in an 11% diluted earnings per share increase to $0.99 per share.

And finally, to our updated fiscal 2023 outlook. We had a strong first half of fiscal 2023, with double-digit reported and organic net sales growth, driven by strong consumer demand and the rebuilding of distributor inventories as supply constraints eased. We remain confident in the collective growth of our U.S. developed and emerging international markets, along with the travel retail channel, as we have now cycled against the more volatile periods of the pandemic and believe we are seeing trends begin to normalize.

We do remain cautious given the current volatility and uncertainty of the global macroeconomic and geopolitical environment as well as the potential impact of inflation and rising energy prices on consumer spending.

We believe the strength of our portfolio of brands, innovation, increased pricing and our strategic investments will enable continued growth through the reminder of the fiscal year, and therefore, we are raising our full year fiscal 2023 organic net sales growth guidance from the mid-single-digit range to the high single-digit range.

As we have shared with you in previous quarters, I would like to reiterate that the seasonality of our fiscal 2023 results will be enacted by the abnormal seasonality of the fiscal 2022 shipments due to supply chain disruptions.

In the first half of fiscal 2022, distributor inventories did not increase ahead of the important holiday season, as is typical. And we experienced stronger shipments in the second half of fiscal 2022 as supply chain challenges began to ease. And as expected, in the first half of fiscal 2023 and distributor inventories continue to return to more normalized levels, which benefited our growth rate by 5 points. Our second half results will lap the increase in the net change in distributor inventory related to the rebuilding of our inventory position in the prior year period.

As it relates to our fiscal 2023 cost, the inflationary environment continues to increase input costs ahead of our expectations and supply options, particularly transportation, logistics and freight remain challenging. As Lawson mentioned, we have taken proactive steps in the first half of the fiscal year to ensure our products would be on shelf ahead of the important holiday season to meet the strong consumer demand for our brands.

We believe these investments support our top line growth, both in the short term and the long term. Additionally, we've noted the impact of foreign exchange on our reported first half results. The U.S. dollar has strengthened against many major currencies. Most notably, we are seeing the negative effect of the appreciation of the U.S. dollar against the euro, Turkish lira and pound sterling.

While we are actively working to navigate these challenges and their impact, we believe the headwinds of inflation, supply chain disruption costs and foreign exchange will persist for the full year. Partially offsetting these headwinds, we continue to expect printing and the removal of the EU and U.K. tariffs on American whiskey to remain tailwinds for the full year.

Based on the stronger-than-expected headwinds, we are updating our reported gross margin for the full year. We now project the reported gross margin for the full year to be consistent with the first half of fiscal 2023, primarily due to combined effects of higher input costs, negative foreign exchange and mitigation costs associated with supply chain challenges. For the last components of our outlook, the outlook for operating expenses remains the same. In addition to our philosophy of growing the investment behind our brands at a rate similar to our top line growth, we are reinvesting a portion of the EU and U.K. tariff relief back behind our brands. And we will also invest behind our people and expect a continued rebound of discretionary spend to support our business needs in a more normalized environment.

We firmly believe that investing in our brands and our people is the right approach to driving strong top and bottom line growth. Based on these expectations, we are also raising our full year fiscal 2023 organic operating income growth guidance from the mid-single-digit range to the high single-digit range.

Our fiscal 2023 effective tax rate guidance remains in the range of approximately 22% to 23%, and our capital expenditures are still planned to be in the range of $190 million to $210 million.

Before I conclude my remarks, I wanted to briefly highlight our long-standing capital allocation philosophy and how it has guided our actions against all 4 principal over the last 12 months. The first principal is to fully invest behind our business. In the last year, we increased capital investments to expand capacities to support the strong long-term demand of our brands, specifically in our Kentucky distilleries, tequila operations as well as our Glendronic distillery.

The second principle is to pay increasing regular dividends. As we announced on November 17, the Brown-Forman Board of Directors approved a 9% increase in the regular quarterly cash dividend. We are proud to be a member of the prestigious S&P 500 Dividend Aristocrat Index, having paid regular quarterly cash dividends for 79 consecutive years and increase the regular dividend for 39 consecutive years.

The third principle is to opportunistically look for acquisitions that we believe create long-term value. While the Gin Mare and Diplomatico Rum acquisition announcements came in quick succession, there has been no change to this guiding principle as timing is reliant on when an owner decides to make a brand available for sale.

And finally, the fourth principle is to seek opportunities to return cash to shareholders in excess of regular dividends. As you will recall, last year, Brown-Forman's Board of Directors declared a special cash dividend of $1 per share or approximately $480 million on our Class A and Class B common stock.

These are a few examples of our guiding principles and actions. Our capital allocation philosophy has allowed us to maintain a healthy balance sheet and has produced superior returns over the long term. We firmly believe our capital allocation philosophy, coupled with our strategic priorities, will continue to deliver strong results for our investors.

In summary, and as Lawson stated, the first half of fiscal 2023 was strong as we delivered double-digit top and bottom line organic growth. Despite near-term challenges and uncertainties, we continue to be agile as we identify ways to mitigate supply chain disruptions to satisfy consumer demand.

We are confident if we use our strategy as our guide, stay true to our values and remain focused on delivering nothing better in the market, we will continue to navigate the ever changing market dynamics.

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

I hate to get granular, but it's the thing I'm getting kind of questions on most this morning is just around the guidance and trying to understand how the pieces fit together because we don't have visibility into currency. So I guess, first, gross margin outlook is worse, but raised the operating profit guidance. So can you just help us bridge those 2 dynamics? How we should be thinking about operating expenses and how we should think about FX and the impact on those metrics?

Leanne Cunningham

So I'll start at kind of the highest level and walk all the way through our kind of our gross margin component for the full year. And we still expect favorable tailwinds from stronger price positioning, the innovation, which we've launched with the Jack Series and Herradura Legend at that higher margin products. And of course, the removal of the EU and U.K. tariffs. Now the headwinds that we have been talking about remain the same, but they – some of them have strengthened.

Essentially, I'll start with inflation on our input cost. For FY '23, we did plan for our inflation on our input cost to be above historic norms. But the current levels on our commodities are beyond what we had expected. And the theme really is the key drivers of energy and fuel, it's everything it takes to make and move both our inputs and our finished goods. So just to give you a little bit of detail around that because I'm sure it's on everybody's mind.

As it relates to our key components, our glass pricing continues to increase because of the commodities that it takes to produce it, which would be natural gas, diesel and fuel and labor. Freight, it's really the cost of fuel that continues to be very volatile, and the diesel prices are at all-time highs. We do see the continued imbalance of the equipment from the global freight and transportation system, and we expect that to continue throughout the full year.

Natural gas, the prices are – they remain elevated even though they did moderate as we got towards the end of our second quarter. And as it relates to grain, again, similar, elevated above what our expectation was and the freight cost to transport our grains to our facilities has increased.

So moving that we are using many mitigation efforts as we look at these global logistics and transportation challenges, we, in this year and when we think about how we planned it, we had planned that, that imbalance of the equipment wouldn't be as significant as it was in the prior year, and we have found that it continues to be.

So we've had to continue to use things such as airfreight and chartered vessels, working to try to get back to our normal shipping lanes as quickly as possible. But with the constraints that were in the environment and trying to get our products on the shelf for the important selling season, we made the decision to invest in those costs to make sure those products were there.

And then to our FX rate. Generally speaking, as you look at Brown-Forman over a long period of time, FX generally isn't a factor or a significant driver in our results as a U.S.-based company this year, it is. So as we think about the remainder of this fiscal year as it relates to our foreign exchange, we see a similar impact in the second half as we had in our first half, therefore, leading us to a full year outlook that our gross – reported gross margin for the full year will be consistent with the rate that we have at the end of this first half.

Now going to your second part of the question, with our strong top growth, Lawson, will talk about that. But we're continuing to invest from an operating expense perspective in line with our philosophies that we talked about in our prepared remarks. So Lawson?

Lawson Whiting

Yes, Lauren, was the question – then about pricing?

Lauren Lieberman

The stronger top line growth.

Lawson Whiting

The stronger top line growth. So I mean that's what – I think, look, the top line organic numbers are very, very strong, and they have remained very strong. A lot of that is – I do think the consumer is pretty healthy. I mean for all indications of our own business, we are not seeing any kind of trade down. In fact, we've actually seen stronger performance even at the higher end of our portfolio. So I mean even – and I think to everyone I know is always interested in the U.S. If you look at the TDS figures in the U.S., you're still seeing premiumization as strong – I don't know as strong as ever because – but it's certainly continuing where the product, the $20, $30 and $40 and above are performing better than the lower value.

So you're not seeing the trade down that so many people have suspected would be coming through. I would say that's – I don't know if it's global, but it's certainly more than just the U.S. We're just not seeing the weakened consumer yet.

Leanne Cunningham

And the last thing I would add is we just continue to be really fortunate in an environment with the inflation on our commodities that we're seeing is that we have a very strong portfolio of premium and super premium brands that are better able to handle these pressures that we're seeing from the macro world.

Operator

Our next question comes from Robert Ottenstein with Evercore.

Robert Ottenstein

Great. Wondering if you could talk a little bit more about Tequila. I think we all understand some of the supply issues. But it's had extraordinary growth. Is it moderating at all just in terms of what you think underlying demand is? And in your view, is rum potentially kind of the next tequila a few years out?

Lawson Whiting

Let's hope so on that last one. So look, tequila. And now predominantly talking about the United States here. I mean we have had some comparisons that have been really, really difficult. And I think that's true across the category and some of the other brands that have had these extraordinary growth rates over the last few years. So that has something to do with it. But we have Herradura probably more than any other brand so far year-to-date, has been constrained by glass.

It's gotten better over the last months, but it was really rough in this quarter. And so we are expecting to see improvement as we move throughout the year. The demand for the brand itself has been so strong in the last few years, but I don't really think it's – I don't think it's so much a weakening in the category or a weakening of consumer demand. I do think it's mostly comps and then in our case, at least glass.

So I still believe it's going to be one of the fastest-growing categories over the next several years, and it's still – we still feel like we have some of the best brands in the business. So – and then, rum, we'll see. Super premium rum is growing very nicely now. It is growing really quickly in Europe.

So this is one of those acquisitions that really is much bigger in Europe than it is in the United States, which is kind of different than most of the acquisitions we've done over the last, say, 10 years.

There's a lot of rum, particularly in Southern Europe, but really across Europe. So it's a big category. We've got one of the best brands, if not the best brands, at these higher price points. And it will be interesting to see what happens in the U.S. business. And does that become a tequila-like growth rate? It's hard to predict those things, but we're in a bet that we can grow and grow that brand into something pretty sizable in the U.S.

Operator

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

Bryan Spillane

So just, Leanne, maybe a clarification, just to follow up on Lauren's question, one clarification and then at another kind of question around just the FX piece. Just – if we're looking at the – you gave the impact or you said in the back half of the year, the impact of foreign exchange I guess, for the full year will be equal to what it's been for the first half on gross profits. Is that same – does that flow through the P&L as well? So will the FX impact on operating income for the full year be similar to what it's been in the first half?

Leanne Cunningham

Yes, it will flow down through the P&L.

Bryan Spillane

Okay. And then just the gap, the fact that it's a much bigger impact on gross – on operating income. Can you just kind of give us a little bit just why that gap is so much – why the FX impact is so much greater on OI versus gross profit?

Leanne Cunningham

So I'll start at the top where our [strip] net sales, as we've reported, is negatively impacted by 6%. That's largely a translational impact, as we said, driven by the appreciation of the dollar against the ones – the currencies that are specific to us, which are the euro, the Turkish lira and the pound sterling.

Gross margin we've already talked about was 140 basis points. That's a bit different than our top line impact because the majority of our products are produced inside of the United States.

And then just flowing down through the rest of the P&L, it has an outsized a magnified impact as you move down just because it's on a smaller base. But there continues to be, as we have said before, no meaningful remeasurement or translational impacts. And we just – it continues to be – it hasn't been a factor for Brown-Forman for a period of time, a key driver. And hopefully, it's one that reverses, and we were not talking about that at some point in the future.

Lawson Whiting

Yes. Bryan, let me add on to it a little bit, too. The – if you guys – I would encourage everyone to look at Page 7 in our – on the accompanying slide deck. I think it – I mean, it lays it out pretty clearly. You can see in there that our price mix and tariffs offset the input costs. As bad as they were, we were calling away with price actions around the world, and then we knew about the tariff money. The killer on the gross margin has been the foreign exchange. So how that plays out the rest of the year, I mean, we will see. But yes, I mean this is an impact that obviously we didn't see coming.

Bryan Spillane

Yes. Lawson, because obviously I've got that. I was looking at the slide and trying to figure out what that looks like for the back half of the year. And I guess you've kind of maybe answered this question. But just the fact that so much of this is FX is why you wouldn't contemplate maybe raising prices or taking other actions to try to offset the margin pressure because it's really something you can't control. Is that the right way to think of it?

Lawson Whiting

That is a fair way to look at it. I mean I think on the pricing question, that's a good one. I mean as we've been talking about, I think, for the last 5 or 6 quarters, we've been trying to change the company's execution of pricing around the world. We – I know you've been around long enough. I mean from 2000, the financial crisis was a really nice blend or balanced view, I guess, between volume and price.

And then the financial crisis hit, and we went through 10 years in this industry with virtually no pricing. We're trying to change that dynamic inside the company right now, which involves – we've said low single digit, that 2% to 3% range, but doing it pretty much everywhere every year. And so that – and we're executing against that and successfully executing against it. And it's been something I think the groups are quite happy with. But that also means you don't turn around on a dime because of foreign exchange movement and try to do something significantly bigger or an input cost movement either.

So we're going to continue that steady climb. And hopefully, over the long run, that's what delivers the most value. At this point, we've – as we've said, we've not chased away consumers through these price increases, which is obviously very good news. And we think we've kind of found the right level of what it takes to maximize sort of consumer demand.

Operator

Our next question comes from Peter Grom with UBS..

Peter Grom

So I guess I just wanted to make sure I'm understanding your response to both Bryan and Lauren's question. So just to be quite specific, I think in the schedule, foreign exchange was a 14-point headwind to operating income in the first half of the year. So if that's the same, does that more or less imply? Like is our math right that reported operating income is going to be down kind of in this mid-single-digit range? A, is that right?

And then I guess just maybe I would love to ask about the implied organic sales guidance for the back half of the year. Can you maybe just remind us what your expectation is for distributor inventories? I know it was 500 basis points tailwind in the first half, but just any color on what you expect for the second half or full year would be helpful. And just – because, I guess, in that context, the implied organic revenue growth to go from high single digits up to 17% in the first half is a pretty meaningful slowdown. So just any color on that would be really helpful.

Leanne Cunningham

Thank you, Peter. And then I'll start with kind of the reminder of the seasonality of our growth, which is for – our seasonality for fiscal '23 on the top line, it is going to be impacted by the abnormal seasonality of our 2022 shipments. And we all lived through that, which – the first half of 2022 with glass supply constraints, we didn't build our inventory ahead of the holiday season, the way we typically do. And then when glass supply challenges began to ease in the second half of our fiscal year, we were able to increase the level of shipments out to the market.

So then as we lap that in fiscal '23, we're continuing to work to rebuild our distributor inventories, as you noted. And you can see on Schedule D, our growth rate in the first half had a 5-point benefit on a year-over-year basis. And again, that second half of this year has to lap the very strong comparisons that we had last year related to our inventory rebuild.

So then going specifically to the rebuild efforts. Since we've been working on this, and we've said this last quarter, as we've been rebuilding inventory, we have continued to experience a very strong consumer demand, and we've launched new innovations. So while our inventory position is improving, there is still some brands and sizes that have to be replenished. So we do believe that inventory – distributor and retailer inventories are below – remain below pre-pandemic levels.

We're making progress on that. And at this point, to the extent that we can look out, we believe our target as far as a return to normal levels would be in the early part of F '24, and we'll talk more about that as we get closer to that fiscal year. But we expect it to remain through this fiscal year.

And then to your other part of FX impact on OI, and we talked about how it flows down the outside. We continue to – for the second half, we only guide on an organic basis, which wouldn't have that FX impact in there.

We are sharing that in this report that our estimate would be is like – our assumption would be that the second half impact of foreign exchange would be similar to the impact of the first quarter – first half, sorry.

Operator

Our next question comes from Nadine Sarwat with Bernstein.

Nadine Sarwat

So given your earlier commentary on gross margin headwinds for this year, I think that was very clear. I'd like to step back and actually focus on the long-term story. So how should we think about your gross margin development, given today's news over the next 1, 2, 3 years? Is there a way that you can quantify what you think you can achieve in terms of expansion in that time period? And then one question on the top line guidance. To what extent is there a downside risk on this stronger guidance from perhaps weaker volumes or mix if a recession were to come and the consumer were to weaken?

Leanne Cunningham

Nadine, as we've talked about before, on gross margin expansion, we have the entire company actively working on all elements of revenue growth management from pricing to effective promotions to all of the elements of [product size], distributor margins, and we are working significantly on our costs.

As we look out, we continue to hope that the imbalance of the freight equipment will subside in this next kind of 1- to 3-year period so we can return to normal shipping lanes, which will have significantly less cost associated with that.

We've been 2 years now with that higher airfreight to get our products to market to continue to support consumer momentum.

FX, again, when we look back over our recent past, it hasn't been a key driver. We can't predict what's going to happen in that space, but we would say as we look over history, it generally isn't a key driver. And then inflation that – we're working to do everything we can to mitigate those costs, but if they're being driven by the macroeconomic environment in which we're operating. And then I think...

Lawson Whiting

Let me add a little bit of color to the freight and logistics line, just to sort of everyone understands that. I mean if you – if we back up 6 months, we were in the throes of some serious glass shortages. We still have some problems now, but it's certainly better. But back in the summertime, we're looking out at really European and international holiday season, we could see that we were not going to be able to get our product to market in the normal way that we do it.

And so we were kind of stuck in a corner and said, all right, we're either going to take on these literally tens of millions of dollars in freight expenses so that we can actually get our products on the shelf or just not sell it. And we chose the former, which I still think ultimately is the right long-term decision.

But back to your gross margin expectations going forward, we will not have – I mean, gosh, I would hope we don't have those coming over the next – really – once we get through this holiday season, we hope to return to normal. It does feel like conditions are moving back towards a normal state again, and then – so that will be a boost to the margin.

Was there anything else?

Leanne Cunningham

Top line and recession?

Lawson Whiting

Oh. Was the question, Nadine, the sort of concern around…

Nadine Sarwat

The question was on the top line guidance that you guys have taken up today. To what extent is there downside risk to that if the consumer were to weaken in a recessionary environment? Or did you guys build that into your assumptions when putting out this new guidance?

Leanne Cunningham

To the extent that we could build in all of the assumptions that we were aware of with the trends and the information we have, it would have been built into the raising of our guidance.

Lawson Whiting

I mean I think I'd still argue. We feel pretty good about the consumer take away. While normalizing, if you look at any of the – I mean, this is a U.S. comment, but the Nielsens and NABCA trends. But we – as we've been saying all along here, we haven't seen the trade down. We haven't seen a weakness in consumer demand yet. I just don't – I tend to believe that not only Brown-Forman, but this category of super premium spirits is an affordable luxury that is one people don't like to give up. And I think the combination of that with strong – the wages remain strong, unemployment, all the other macro things that are working well. I think it's a relatively low risk.

Operator

Our next question comes from Kevin Grundy with Jefferies.

Kevin Grundy

Lawson, I wanted to take a step back and ask about your ready-to-drink strategy. Just strategically, you've had a lot of success so far. And it seems like it's going to increasingly become a bigger part of your portfolio as well as your peers. How do you think about it within the portfolio? How do you think about margin implications relative to the base portfolio? It certainly will be negative from a mix perspective. But just broader thoughts on how this is going to evolve within the portfolio? How do you attempt to limit cannibalization and maybe some updated thoughts on the Jack & Coke RTD?

Lawson Whiting

Yes. So I mean that's obviously – the story right now is the Jack & Cola RTD, which just launched in Mexico a few weeks ago. So obviously, only in the first few days of launch, but moving.

Yes, we remain very excited and very optimistic on what we can do in this category. RTDs, obviously, if you look at the U.S. trends, RTD – spirit-based RTDs are flying driven by a few very big brands. And we hope to join those ranks over the next year.

We'll be launching in the first half of 2023 in the U.S., in the U.K. and then a handful of different European and Asian markets. Now just to make sure everyone – I don't know how much of this we've given out. In the U.S., in Germany and Australia, Brown-Forman will be doing the sales, and that is a bit margin dilutive if RTDs were to get massive. Now Germany and Australia are already really big businesses.

And so moving forward, we don't expect a lot of dilution from that – from those markets. But when you get to the rest of the world, it's different. Coca-Cola is doing the sales, and we're selling bulk. And so that is not a dilutive margin.

So it's mixed as to how that's going to look going forward. But at the end of the day, these are brands that we really believe are the – Jack & Cola brand is something that we very much believe in as a long-term play with really nice growth look at it.

Leanne Cunningham

And then what I would add to that is – and I know you're aware of this. I mean we've had – we've been in business for 30-plus years. We have had over 20 million cases of that volume in our sales mix. And it's going to depend on a market-by-market basis, but we don't see a significant impact to our long-term company margin over a period of time because, again, in a way, we'll be transitioning some of this business from the Jack & Cola business that we have, which again, we – this is an attractive opportunity for us to continue to increase our geographic reach and to gain share and to potentially even premiumize the product.

And again, we believe it has a halo effect on our full strength brand, and that halo effect will now be extended into geographies where we haven't had the opportunity to kind of get our product there before.

Lawson Whiting

Yes. That's a reference a lot of it is to the emerging markets around the world where we're just small. So take on Africa, just to pick one big continent that has a hard time affording a full bottle of Jack Daniel's. Well, this is a totally different offering and something that we think can be scaled up and be a pretty big opportunity. But then, as Leanne said, becomes a sort of a halo effect on the rest of the brand. It just – it develops a lot more awareness because you've got that can in a hand in a market that we think can be very, very big.

Operator

Our next question comes from Nik Modi with RBC.

Nik Modi

Lawson, I was hoping maybe you could just provide an update on where the glass situation stands? Because it seems like not just in spirits companies, but companies outside of spirits, like the fragrance companies are having a big challenge right now with glass availability and supply. And I'm just curious kind of do you think it might get worse? Will it impinge your ability to rebuild inventories the way you're expecting? And if not, how are you securing this glass when I know a lot of your competitors are still struggling?

Leanne Cunningham

So I'll start with that one from a glass supply perspective. I think you heard us say multiple times throughout our prepared remarks is that our glass supply constraints are easing. So maybe we were just early in the cycle of constraints, but we have done and had the opportunity to really actively work with our current suppliers, and we've increased our capacity. They've improved their yield. And we've also worked closely with them for prioritization of our products on their lines.

We've also taken the opportunity, like you've heard us say, is to broaden our supplier base. We've been able to do that both inside of the United States as well as internationally. And that – so largely for us, it's easing. We do have some spaces where we are still facing constraints, as Lawson talked about that, that would be Herradura in Mexico. And we have plan in action for increased supply that we're bringing online in this fiscal year.

So all in all, for us, we believe we are kind of moving beyond – we're still living with and moving beyond glass supply constraints. And you can see in the growth of Woodford Reserve and Gentleman Jack, how they have responded to that easing of that constraint and returning back to very strong growth. And then now moving more into the global logistic challenges of the world.

Operator

Our time for questions has ended. I would now like to turn the call back over to Sue Perram for any closing remarks.

Susanne Perram

Well, thank you. And thank you, Lawson and Leanne, and thank you to everyone for joining us today for Brown-Forman's Second Quarter and First Half of Fiscal 2023 Earnings Call. If you have any additional questions, please contact us. To wrap up today's call, we would like to offer you a toast, to the spirit of the season and a vibrant New Year. Cheers to everyone. With that, this concludes our call.

Operator

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