Q2 2022 Earnings Call

Company Participants

- Andre Schulten, Chief Financial Officer
- Jon R. Moeller, President and Chief Executive Officer

Other Participants

- Analyst
- Chris Pitcher
- Christopher Carey
- Dara Mohsenian
- Jason English
- Kaumil Gajrawala
- Kevin Grundy
- Lauren Lieberman
- Mark Astrachan
- Peter Grom
- Robert Ottenstein
- Stephen Robert Powers
- Sunil Modi
- Wendy Nicholson
- William Chappell

Presentation

Operator

Good morning, and welcome to Procter & Gamble's Quarter End Conference Call. Today's event is being recorded for replay. This discussion will include a number of forward-looking statements. If you will refer to P&G's most recent 10-K, 10-Q and 8-K reports, you will see a discussion of factors that could cause the company's actual results to differ materially from these projections.

As required by Regulation G, Procter & Gamble needs to make you aware that during the discussion the company will make a number of references to non-GAAP and other financial measures. Procter & Gamble believes these measures provide investors with useful perspective on underlying business trends, and has posted on its Investor Relations website, www.pginvestor.com, a full reconciliation of non-GAAP financial measures.

Now, I will turn the call over to P&G's Chief Financial Officer, Andre Schulten.

Andre Schulten {BIO 22079652 <GO>}

Good morning, everyone. Joining me on the call today are Jon Moeller, President and Chief Executive Officer; and John Chevalier, Senior Vice President, Investor Relations. We're going to keep our prepared remarks brief and then turn straight to your questions.

Q2 was a strong quarter, very strong top-line growth, sequential earnings progress in the face of significant cost headwinds, continued strong cash productivity. Our progress enabled us to confirm fiscal year EPS guidance, while increasing our estimates for top-line growth, cash productivity and cash return to shareowners.

Organic sales grew more than 6%. Volume contributed 3 points of sales growth. Pricing added 3 points as September/October price increases flow through and as year-on-year promotion comparisons normalize. Mix was neutral for the quarter.

These strong company results are grounded in broad-based category and geographic strengths. Each of the 10 product categories grew or held organic sales in the quarter. Personal Health Care grew 20%, Fabric Care and Feminine care were up double digits, Baby Care up high-singles, Grooming grew mid-singles. Home care, Oral Care, Hair Care and Skin and Personal Care, each grew low single-digits. Family care organic sales were in line with prior year.

Focus markets grew 6% and enterprise markets were up 7%. In focus markets, U.S. organic sales were up 9%, despite 12% growth in the base period. On a two-year stack basis, U.S. organic sales are up 21%. Europe focus markets were up 5%.

Greater China organic sales were in line with prior year against the strong 12% base period comp and due to slower market growth in the quarter. In addition, we took proactive steps in the quarter to encourage our network of distributors to reduce inventory levels to reflect short-term consumer demand softness in the market.

Latin America led the growth in enterprise markets up 15%. Global aggregate market share increased 60 basis points, 38 of our top-50 category country combinations held or grew share for the quarter.

Our superiority strategy continues to drive strong market growth and, in turn, share growth for P&G. All channel market value in the U.S. categories in which we compete grew nearly 3.5% this quarter. P&G value share continue to grow, up nearly 1.5 points versus same quarter last year, now at 34%. Importantly, the share growth is broad-based. 9 of 10 product categories grew share over the past 3, 6 and 12-month periods in the U.S.

Consumers continue to prefer P&G brands and superior performance they provide, even as inflation is impacting household budgets. On the bottom line, core earnings per share were $1.66, up 1% versus the prior year. On a currency-neutral basis, core EPS increased 2%.

Core gross margin decreased 400 basis points and currency-neutral core gross margin was down 410 basis points. Higher commodity and freight costs impacts combined were a 460 basis points hit to gross margins. Mix was a 140 basis point headwind, mainly from product mix impacts. Productivity savings and pricing each provided partial offsets to the gross margin headwinds.

Within SG&A, advertising spending increased versus prior year, as we continue to invest to communicate the superiority of our brands. However, overall marketing expenses as a percentage of sales decreased 80 basis points, driven by sales leverage and savings in non-working marketing costs.

Core operating margin decreased 250 basis points, currency-neutral core operating margin declined 240 basis points, productivity improvements were 150 basis points help to the quarter.

Free cash flow productivity was 106%. We returned nearly $7 billion of cash to shareowners, approximately $2.2 billion in dividends and $4.8 billion in share repurchase. In summary, while input costs and supply chains remain challenging, we delivered good results for the second quarter and for the first half of the fiscal year, keeping us on track to deliver our going-in earnings estimates and to raise estimates for sales, cash productivity and cash return to shareowners, which I'll come back to later.

Moving on to strategy. Our team continues to operate with excellence and stays focused on the near-term priorities and long-term strategies that enabled us to create strong momentum prior to the COVID crisis, and to make our business even stronger since the crisis began. We continue to step forward into the challenges and to double down our efforts to delight consumers.

As we continue to manage through this crisis, we remain focused on the three priorities that have been guiding our near-term actions and choices. First is ensuring the health and safety of our P&G colleagues around the world. Second, maximizing the availability of our products to help people and their families with their cleaning, health and hygiene needs. Third priority supporting the communities, relief agencies and people, who are on the front lines of this global pandemic.

The strategic choices we've made are the foundation for balanced top- and bottom line growth and value creation. A portfolio of daily use products, many providing cleaning, health and hygiene benefits in categories, where performance plays a significant role in brand choice. In these performance-driven categories, we've raised the bar on all aspects of superiority, product, package, brand communication, retail execution and value.

Superior offerings delivered with superior execution drive market growth in our categories, this drives value creation for our retail partners and builds market share for P&G brands. The superiority model works in each of our categories. Take the three category growth drivers, this quarter, Personal Health Care, Fabric Care, and Feminine Care. Very different categories, different competitors, different geographic footprints, and different materials and manufacturing processes. Each delivering superiority and each growing organic sales double-digits. In each of these categories, P&G is driving a disproportionate share of overall category value growth, growing the pie for all participants.

We've made investments to strengthen the health and competitiveness of our brands across innovation, supply chain and brand equity and will continue to invest to extend our margin of advantage and quality of execution, improving solutions for consumers around the world. Building on the strength of our brands, we are thoughtfully executing tailored price increases, we closed couple of price increases with innovation to improve consumer value along the way.

The strategic need for investment to continue to strengthen the superiority of our brands, the short-term need to manage through this challenging cost environment and the ongoing need to drive balanced top- and bottom-line growth, including margin expansion, underscore the importance of ongoing productivity. We're committed to driving cost savings and cash productivity in all facets of our business. No area of cost is left untouched. Each business is driving productivity within their P&L and balance sheet to support balanced top- and bottom-line growth and strong cash generation.

Success in our highly-competitive industry requires agility that comes with a mindset of constructive disruption, a willingness to change, adapt and create new trends and technologies that will shape our industry in the future. In the current environment, that agility and constructive disruption mindset are even more important. Our organizational structure yields a more empowered, agile and accountable organization with little overlap or redundancy, flowing to new demands, seamlessly supporting each other to deliver against our priorities around the world.

These strategic choices of portfolio, superiority, productivity, constructive disruption and organization structure and culture are not independent strategies, they reinforce and build on each other. When executed well, they grow markets, which, in turn, grows share, sales and profit. These strategies were delivering strong results before the crisis, have served us well during these volatile times, and we're confident, they remain the right strategic framework as we move through and beyond the crisis.

Moving on to guidance. We said last quarter that we would undoubtedly experience more volatility, as we move through the fiscal year. The Omicron variant has certainly proven this to be correct. As we saw in the first half of the fiscal year, growth results going forward will be heavily influenced by base period effects, along with these realities of current year cost pressures, foreign exchange volatility and continued effects of the global pandemic on supply chains and consumer behavior.

Transportation and labor markets remain tight, availability of materials remain stretched in some categories and, in some markets. Inflationary pressures are broad-based with little sign of near-term relief. These costs and operational challenges are not unique to P&G and we won't be immune to the impacts. However, we think the strategies we've chosen, the investments we've made and the focus on executional excellence has positioned us well to manage through this volatility over time.

The recent spike in virus cases and resulting lockdowns increase the risk of additional work stoppages in our operations or in those of our suppliers. Based on current spot prices, we now estimate a $2.3 billion after-tax commodity cost headwind in fiscal '22.

Since our last update, we've seen continued increases in diesel and chemicals with little offset in other materials. Freight costs have continued to increase. We now expect freight and transportation costs to be an incremental $300 million after-tax headwind for fiscal '22. Foreign exchange range have also moved against us since our last guidance. We now expect FX to be a $200 million after-tax headwind to earnings for the fiscal year.

We will offset a portion of these cost pressures with price increases and with productivity savings. We've now announced price increases in each of our 10 product categories in the U.S., increases in Baby Care, Feminine Care, Adult Incontinence, Family Care, Home Care, Hair Care, Grooming, Oral Care, Skin Care are now effective in market. We also increased prices on mid-tier liquid detergents and powder detergents over the last few months.

In mid-December, we announced to retailers that effective February 28th, we are increasing pricing on the balance of our Fabric Care portfolio. This includes Tide, Gain, Downy, Bounce and Unstopables and includes all forms, liquid and unit dose detergents, scent beads, liquid fabric softeners and dryer sheets.

Just yesterday, we announced to retailers that we are increasing pricing on certain personal health care brands in the U.S. effective mid-April. The degree and timing of these moves are very specific to the category, brand and sometimes, the product form within a brand. This is not a one-size-fits-all approach. We're also taking pricing in many markets outside the U.S. to offset commodity, freight and foreign exchange impacts.

As we've said before, we believe this is a temporary bottom line rough patch to grow through, not a reason to reduce investment in the business. We're sticking with the strategy that has been working well before and during the COVID crisis.

Moving to the key metric guidance. We now expect organic sales growth in the range of 4% to 5% for the fiscal year, up from our initial range of 2% to 4%. We expect pricing to be a larger contributor to sales growth in the back half of the fiscal year, as more of our price increases become effective in the market. As this pricing reaches store shelves, we'll be closely monitoring consumption trends. So far, we haven't seen noticeable changes in consumer behavior. Demand for our best performing premium-priced offerings remains very strong, as do our market share trends.

On the bottom line, we're confirming our outlook of core earnings per share growth in a range of 3% to 6%. In total, our revised outlook for the impact of materials, freight and foreign exchange is now a $2.8 billion after-tax headwind for fiscal '22 earnings, or roughly $1.10 per share, a 20 percentage point headwind to core EPS growth. Despite these cost challenges, we are committed to maintaining strong investment in our brands. As pricing goes into effect, that as we annualize the initial spike in input costs, earnings growth should be sequentially stronger in the third and fourth quarter of the fiscal.

We are increasing our outlook for adjusted free cash flow productivity to 95% and we are raising our guidance for cash return to shareowners. We continue to expect to pay over $8 billion in dividends and we now plan to repurchase $9 billion to $10 billion of common stock. Combined, a plan to return $17 billion to $18 billion of cash to shareowners this fiscal year.

This outlook is based on current market growth rate estimates, commodity price and foreign exchange rates. Significant additional currency weakness, commodity cost increases, geopolitical disruptions, major supply chain disruptions or store closures are not anticipated within the guidance ranges.

To conclude, our business exhibited strong momentum well before the COVID crisis. We've strengthened our position further during the crisis and we believe P&G is well positioned to grow beyond the crisis. We will manage through the near-term cost pressures and continued market level volatility with the strategy we've outlined many times and against the immediate priorities of ensuring employee health and safety, maximizing availability of our products and helping society overcome the COVID challenges that still exists in many parts of the world.

We will continue to step forward toward our opportunities and remain fully invested in our business. We remain committed to driving productivity improvements to fund growth investments, mitigate input cost challenges and to maintain balanced top- and bottom-line growth.

With that, we will be happy to take your questions.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) Your first question comes from the line of Dara Mohsenian with Morgan Stanley.

Q - Dara Mohsenian {BIO 3017577 <GO>}

Good morning. So on the top-line side, clearly strong results across the board, but Beauty top-line growth was below consensus in the quarter. So just any thoughts on the Beauty top-line performance? And specifically, maybe you can talk about China Beauty from a category and market share perspective in the December quarter. And any go-forward thoughts on China Beauty or China in general, given the flattish year-over-year trends in the quarter?

And then on the rest of the business, with the strong market share results, can you just talk about your level of confidence going forward in sustaining those share gains? And how supply chain and consumer and retailer acceptance of price increases may impact the forward outlook from a market share perspective? Thanks.

A - Jon R. Moeller {BIO 16200095 <GO>}

All right. Morning, Dara. That's a lot. So let me start with maybe two, and focus on Beauty and China within that. Look, if you look at our Beauty business over a longer period of time, the business has actually delivered about $3 billion in incremental sales over the past five years; more than $1 billion of incremental profit; significant contribution to shareholder return; 25 consecutive quarters of organic sales growth, including this quarter.

When we look at this quarter on a two-year stack, on Beauty, it's a 7% for quarter two, quarter one was a 9% stack. Hair Care growing 2%. Skin and Personal Care growing 3%. So we feel good about the overall performance of the Beauty business and the strength of the core portfolio. There is significant runway. I'll comment on China in a minute. We certainly saw a slowdown in some of the Beauty portfolio, namely SK-II, which we've mentioned before. Store closures of department stores, lower traffic there. And also slower key consumption periods in some of the China events. And honestly, our unwillingness to go into very deep discount levels on the brand have contributed to a slower growth in quarter two.

Overall, the portfolio is strong, we believe, has very strong growth potential in the future. We are also excited about the acquisitions we've announced, Tula Pharmacy Beauty and Ouai, all focused on the premium end of the trade in the U.S. Premium consumers, which is giving us opportunity for additional top-line growth and value creation in the U.S. and also globally.

On China, I'll start with a similar comment. China, over the past four or five years, has delivered high singles or low-teen sales growth. We have a stable of very strong brands. We continue to believe that consumption after a weaker period in quarter one, as you have seen, and quarter 2 in the market. Consumption in our categories will return to mid-singles. And we feel well positioned to benefit from that growth with a strong organization, strong supply chain and strong R&D capability on the ground.

The other point to note, even with China being flat in the quarter, from a global perspective, we were able to grow more than 6%. And part of that is the strength of the geographic portfolio that we need to focus on because in some markets, we might have to invest. China certainly is, at this point in time, as you point out, weaker in an overall -- from an overall consumption standpoint.

So I'll stop there. I'm sure we'll get back to your other questions and some of the other comments, Dara.

Operator

All right. Your next question will come from the line of Lauren Lieberman with Barclays.

Q - Lauren Lieberman {BIO 4832525 <GO>}

Great. Thanks. Good morning. I was curious to talk a little bit about productivity. The contribution this quarter was only, I think, it's 80 basis points that was cited in the release. And just I would guess that means a big ramp up in the second half. So I was curious why, relative to timing of, it has to do with COVID and absenteeism, if it's related to how you calculate this based on raw material access and so on. But just anything you can share on productivity plans and timing would be helpful. Thanks.

A - Andre Schulten {BIO 22079652 <GO>}

Yes. Good morning, Lauren. Productivity, the number of 80 basis points in the quarter, we expect about $800 million BT productivity contribution from cost of goods for the year. And it's a little bit lighter than what we would have done in previous years. But most importantly, we remain fully committed to productivity as a core driver of margin expansion.

In the short-term, there are a couple of effects that I want to spend a minute on. Number one, when you think about cost savings projects, they require line time. That line time is competing with the need to ship cases in a very constrained supply chain. When we think about innovation, we talk frequently about our desire to close a couple of price increases with innovation. Innovation also needs line time. So cost savings projects on the line also compete with innovation, and they compete with our desire and need to ship the business. Therefore, in a constrained environment as you point out, our businesses make the decision to focus on innovation, focus on shipping the business, which is better for retailers, better for consumers, better for us in terms of value creation, but it has an impact on cost savings.

The good news is these cost savings are available to us in the future. They don't go anywhere, but you see a little bit slower ramp up in that context.

Second element I would mention is the global pressure on supply chain and the flexibility that we've talked about that our supply people have generated doesn't come for free. So when we need to shift to alternate materials, when we need to shift to alternate suppliers, all our sources of materials geographically, that comes as a premium, which goes against productivity. Again, the right choice because shipping the cases is financially more viable than creating the cost saving, but it has an impact.

And then the last point I'll make is negotiating commercial savings when everyone is trying to get the materials in sufficient quantity is also a bit more difficult. So all of that to say, short-term pressure, longer term fully committed to productivity being a core driver of margin expansion and balanced growth model, and you'll see progress quarter-by-quarter.

A - Jon R. Moeller {BIO 16200095 <GO>}

And I would just add, Lauren, that Omicron hasn't helped. It further pressurizes the dynamics that Andre spoke about, and it just reduces the resources we have available at any point in time to work on these things. When -- as people become infected and need the quarantine, as they need to take care of family members, as children schools are closed, all of those things have a real impact, which, to Andre's point, should lighten as hopefully everyone on the call, please cross your fingers as we go forward.

Q - Lauren Lieberman {BIO 4832525 <GO>}

Great. Thank you.

Operator

All right. Next question comes from the line of Steve Powers with Deutsche Bank.

Q - Stephen Robert Powers {BIO 20734688 <GO>}

Hey, thanks and good morning. Maybe building on that a little bit. So as we think about the back half and the levers that you have at your disposal to offset the $2.8 billion in commodity freight currency headwinds that you now face, I guess can you talk a little bit -- let's just elaborate a little bit more on the initiatives that you've put in place specifically over the last three months to help with that as we get into calendar '22? And I guess I'm specifically curious, when we think about the second half P&L, as to how you anticipate the drivers of organic growth shaking out, price versus volume, number one? And then number two, whether we should expect marketing inclusive of non-working media productivity to remain a continued source of positive leverage as the year continues?

A - Andre Schulten {BIO 22079652 <GO>}

Good morning, Steve. All right. So from a gross margin perspective, a couple of things will come to play here. If you assume that the existing commodity foreign exchange rate and transportation and warehousing pressures remain at this level, which is our basis for planning, we will benefit from more pricing flowing through the P&L. Most of our price increases, as you've seen in our prepared remarks, have gone -- or some have gone into effect in September and October, but the majority of the price increases are still coming into effect over December, quarter one, quarter three and quarter four. So the contribution of pricing both to the gross margin recover as well as to the price mix line within the top-line is going to increase sequentially as we go through the fiscal year.

We also will see, in the base period, the commodity pressures are coming into the base gross margin, starting with the third quarter and then really flowing in in the fourth quarter base comparison. So that's going to help the gross margin comparison as well. And lastly, the continuation of, hopefully, more stability in the labor force, more stability around COVID as we exit this winter, will allow us to increase contribution from productivity, as I've talked before, which will also help gross margin recovery in the second half.

On the pricing contribution versus volume contribution, I expect price to become a bigger part, as I said, logically, because of the timing of the price increases that we have announced. And in terms of ability to sustain the pricing, we have seen, for the price increases where we have sufficient read period at this point in time, we have seen a more benign reaction of the consumer. The consumer is healthy generally and is preferring our brands. We're starting with strong superiority, and price elasticity has generally been lower than what we would have seen historically, which also speaks to the fact that we hopefully will continue to see volume growth in combination with the stronger price growth in the back half.

A - Jon R. Moeller {BIO 16200095 <GO>}

I just want to underscore something that Andre said. Remember that the pricing that we've announced, even though pricing has taken effect at shelf, we didn't have a full quarter benefit from in the quarter we just completed. So that simple roll forward is a help. And the majority of the pricing that we've announced has not yet taken place.

Operator

All right. Next question will be from Jason English with Goldman Sachs.

Q - Jason English {BIO 16418106 <GO>}

Hey. Good morning, folks. Thank you for sliding me in. I wanted to drill a little bit deeper on the cost and price outlook. So a couple of things. First, in response to that last question, I think I got the sense like clearly telegraphed this, that the pricing will continue to build. Back half, it sounds like you're looking for at least 4%, if not more, price contribution or at least about $1.5 billion or so net sales contribution. If we look at your cost of both commodities and freight in the $2.6 billion, I think from your margin bridge, it implies that you've already absorbed around $1.7 billion in the front half. So in other words, you're expecting $1 billion or less in the back half. And we should, therefore, expect a price cost surplus to emerge. I want to make sure I had all my math right on that, at least, directionally.

And then second part, you've clearly had to revise your commodity and freight outlook up the last few quarters. Remind us again what the current commodity outlook is predicated on so that we can get a proper sense of what the upside, downside risks are to that. Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

Yes. Good morning, Jason. On the commodity and transportation warehousing timing, yes, I mean, I assume your math is right. I won't check it here, but we can certainly follow up as needed. We assume in our forecast, in our guidance, spot prices for both the commodity basket and for transportation and warehousing. We've seen increases still in this last cycle as reflected in the increase in commodities and transportation and warehousing, but we're also seeing a slower rate of increase. So hopefully, meaning that we reach the peak here soon. But we are building our financial forecast and our financial planning on that level. So we don't assume any easing in terms of transportation and warehousing or commodity cost impact or foreign exchange for that matter.

Operator

Next question will come from Robert Ottenstein with Evercore ISI.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great. Thank you very much. I was wondering if you could give us some sense of how you assess your revenue management skills at this point. Clearly, the results would suggest they're pretty positive. But I'd love to understand maybe some of the changes that you've done over the last few years to improve your ability to manage in an inflationary environment if, in fact, that is what we're headed into for a long period; your ability to work with different elasticities; manage trade spend, et cetera, both in the U.S. and overseas. And how it may be better than it was in the past?

A - Andre Schulten {BIO 22079652 <GO>}

Very good morning, Robert. If I step back, I think we're better positioned for dealing with an inflationary environment or revenue management in that sense than we've ever been before. Starting with a portfolio that is focused on daily use categories, health, hygiene and cleaning that are essential to the consumer versus discretionary categories, which in these environments are the first ones to lose focus from the consumer. Secondly, starting with a portfolio that is 75% superior by our assessment and reflected probably in the market share results and trends that we're seeing. We also, over time, have built much stronger price ladders. So we have offerings for the consumer at different price points and different cash outlays.

When you think about diapers, you can get a large diaper for $0.15 a diaper, swaddlers at $0.30 or pure diaper at $0.38. And that's generally true across all categories, across all brands. So that means the consumer has a choice within our portfolio. So in that sense, I think we are set up well from a starting point to deal with inflation and related pricing.

From an execution standpoint, I think we also benefit from a couple of things. Number one, the organizational redesign in focused markets and enterprise markets enables much faster and much clearer decision-making, which is critical in these processes and also much more diligence in terms of where to take pricing, country, brand, SKU level.

And the other element here is that from an execution standpoint, we certainly have seen that innovation can play a significant role. And the strength of our innovation pipeline and our ability to combine pricing with innovation is certainly helping us in this environment.

Last point I'll make, and then Jon will probably have comments here as well, we've been operating in high-inflation environments around the world for many years. Think about Turkey, Nigeria, Argentina, those are high inflation markets and environments. So we know how to deal with that. Obviously, we hope we don't get to that place, but generally well positioned for the reasons I tried to outline here.

A - Jon R. Moeller {BIO 16200095 <GO>}

And just a reminder of the obvious, we're dealing with commodity cost increases that affect every competitor, both multinational and local, which changes the dynamic pretty considerably versus, for example, pricing for foreign exchange, which has a differential impact across the competitive set. So it's not an easy job, but it's an easier job that we've managed, as Andre said, successfully in many geographies in the recent past.

Operator

Next question will come from the line of Kevin Grundy with Jefferies.

Q - Kevin Grundy {BIO 16423871 <GO>}

Great. Thanks. Good morning. I wanted to pivot and ask about M&A on a couple of different fronts, please. Just number one, the openness to larger scale M&A at this point. I think there was clearly a period in recent years, post the portfolio rationalization, where the company was sensibly very focused on turning around the portfolio, larger scale M&A wasn't really on the table. So is the organization in a better place as the Board open to larger scale deals at this point? And if so, maybe you could put some guardrails around that.

And then relatedly, Andre, you touched on some of the smaller tuck-in deals in Prestige, Beauty, which have been picked up here. Maybe just spend a moment there to find the approach in Prestige, Beauty given past missteps and the decision to exit some of the larger brands that were once in the portfolio there, I think that would be helpful. Thank you for that.

A - Jon R. Moeller {BIO 16200095 <GO>}

Hey Kevin, this is Jon. A couple of points on large M&A. The first very, very important point is we like our current portfolio. We have confidence that we can create value with that portfolio. And frankly, all parts of it are working. Andre mentioned that we're growing market share in 9 out of 10 of those categories. And importantly, that market share growth is not taking business, it's creating business in large part, affecting the overall growth of the market. So we're in a very healthy situation with a very healthy portfolio that's underpinned with a clear set of priorities and a very effective tightly integrated set of strategies.

And we're adding -- or we're strengthening our strategic execution by a focus on four areas. One is supply, the second is digital confidence across the value chain, the third is employee value and the fourth is sustainability. We like that hand overall.

Second point, our algorithm, growing slightly ahead of the market with EPS up mid to high-singles, assumes 100% organic growth. So again, we don't need large M&A to deliver against that. And we certainly haven't utilized large M&A in the last four or five-year period when we've been delivering very regularly on that expectation.

A couple of other points, and then I'll get to Beauty, and then Andre may have some comments on Beauty as well. The -- we have said many times that there -- that we intend to win in these 10 categories that we've selected. And that acquisition would be a part of the way that we may choose to fill out categories in order to win. And we've talked about two categories, in particular, that would be particular focus areas. One is Skin Care, and the other is Personal Health Care. So all of that remains as true.

The last point I would make, which is, I realize, not very helpful to the audience at hand, but as a matter of policy, we don't comment further than what I just have on acquisition or divestiture.

On Beauty, I want to clarify what I think has been a little bit of a misunderstanding. When we made the portfolio decisions as to what we were going to move out on Beauty and what we were going to stay in, we did not make price tier decisions. We did not exit Premium Beauty. We made category decisions. And we exited several categories that were more discretionary, that were not daily use and where performance had a lower role in driving brand choice.

So for example, we maintained our most premium Beauty offering, SK-II. So this notion that we're -- we've got out of a price here and now we're getting back in, is not the way to think about it. We got out of categories, and we're strengthening those categories. And these -- the brands that we have purchased, as Andre said earlier, play in the premium portion of the Beauty categories, which are the fastest growing from a market standpoint to-date and obviously give us ample opportunity to create value given their margin structure.

Andre, anything to add?

A - Andre Schulten {BIO 22079652 <GO>}

Nothing to add.

Operator

Your next question comes from the line of Andrea Teixeira with JPMorgan.

Q - Analyst

Thanks and good morning. This is actually Coe Joanne for Andrea here. So just in terms of service levels, can you please comment on your ability to fulfill just given the impacts of employee absenteeism? And has it improved from the peak on Omicron worldwide? Thank you guys.

A - Andre Schulten {BIO 22079652 <GO>}

Good morning. Our ability to supply is relatively stable, it's stable actually. If you look at our on-shelf availability, for example, in the U.S., last quarter, we reported that was around 94%. We're still running at around 94%, which is not where we want to be, which would be more in the 98%, 99% range, but good relative to peer group and good given, again, the overall challenges the industry is seeing, the retail environment is seeing. So -- and that is true around the world. Our supply chain people, who deserve all the credit here, continue to do an absolutely amazing job, making sure that our retail partners have the products available that our consumers want to buy. And there are no major outages given the flexibility we've created within the supply chain.

Even in China, as we saw regional lockdowns, we were able to shift production into alternative sites and thereby maintain supply. So continued great work by our supply organization, relatively stable situation. We'll continue to monitor closely because this is not over. So great success now with no guarantee for the future, but we certainly feel well positioned.

Operator

All right. Next question will be from the line of Chris Carey with Wells Fargo Securities.

Q - Christopher Carey {BIO 21810941 <GO>}

Hi, good morning. So one quick follow-up on SK-II. Are you seeing that slowdown as temporary, some normalization in demand? Or do you think the brand is reaching some ceiling on growth and hence, you've made these additional moves? And then a broader question just on pricing in Baby. Price mix in the category has really accelerated. It doesn't seem like it was that long ago that the category was seeing higher promotional activity to drive volumes. Can you just expand on the step change there, the drivers of the move on pricing and premiumization, why it's the right move? And then maybe any broader thoughts on -- there's been some discussion around a little bit of a mini baby boom. And I wonder if you have any thoughts there. Thanks so much.

A - Andre Schulten {BIO 22079652 <GO>}

All right. Good morning. On SK-II, certainly no ceiling for the brand in terms of growth. The brand continues to carry enormous equity with existing users, enormous appeal to new users, specifically in the Asia space. So we continue to be very encouraged by both the current strength of the brand, but also by the future pipeline and the initiatives that are to come. But the brand is operating in channels that are most impacted by the pandemic. That has an impact on our business. It has an impact on total consumption.

And lastly, I mentioned this in the earlier question, we don't believe that heavy discounting is the right strategy in the short term to overcome some of these challenges. So we're focusing on building the equity, building product efficacy and running our business model to return to stronger growth here in the future.

On the Baby category, you're right, price/mix when you look at the U.S., but also globally is increasing, which is encouraging for two reasons. Encouraging number one, Baby Care is one of the hardest-hit categories from a commodity impact. So it's good to see that the pricing that was taken is flowing through to the P&L to help with productivity, offset some of that commodity pressure. And we see the pricing in Baby flowing through really globally, so that's a core driver. And every player in the industry, as Jon mentioned before, has to find a way to offset these cost pressures that are very significant in this category.

More encouraging to me is in our portfolio, the desire of the consumer to move up to higher premium offerings because they truly provide better value for the consumer. When you think about the U.S., for example, most of the growth, if not the absolute majority of the growth, comes from Tier 1, our swaddlers proposition, comes from Cruisers 360, which is a very unique proposition in the pants form for active babies comes from Pampers Pure and comes from Ninjamas, which is a bedwetting product, which we reentered the category, created significant growth in the category and build a 9% share position.

So the portfolio strategy we're executing, the innovation we're bringing is rewarded by the consumer with trade up. And that is a significant contributor to price/mix and hopefully, and I think sustainable given the true benefits we're seeing the consumer appreciate.

A - Jon R. Moeller {BIO 16200095 <GO>}

Just a couple of additional points on SK-II to hopefully make it clearer and bring it to life what's actually happening here. If you dramatically simplified the SK-II business, you would simplify it historically into two primary channels. One is travel retail, and the other is department store. And in both of those channels, it was -- it's typically been a counseled product, meaning there's some -- there's a knowledgeable person in the store to help you understand the benefits of the product and which elements are right for you.

With COVID, travel retail largely closed. In many parts of Asia, inability of counselors to go to work for the multitude of reasons we're all familiar with, including some regulatory prohibitions. If you look at Japan, you have that dynamic, plus you have what was a major source of business, which was Chinese travelers going to Japan to department stores to buy a product to bring back to their friends and family, that's not happening.

So when you ask why is SK-II currently soft, those are the reasons. And, as Andre indicated, has nothing to do with the equity or strength of the brand. We've converted, and I really applaud the team for doing this, a fair amount of that purchase from those channels to more local channels that support consumption, but still the impact has been significant.

Operator

All right. Next question will come from Wendy Nicholson with Citi.

Q - Wendy Nicholson {BIO 2081269 <GO>}

Hi. I wanted to just go back and talk about the M&A strategy for a minute. Just with regard to not just the smaller brands that you've just recently announced acquiring, but maybe looking back. And can you give us kind of a little bit of an update on some of the smaller brands you bought historically, whether it's First Aid Beauty, whether it's native or This Is L., just to sort of tell us how have they done? Has it been worth the effort? How fully integrated are they? Because again, back to the earlier discussion about M&A, I think the question I would have is these are small companies that obviously are growing rapidly now, but is it worth the hassle? Is it worth the effort? Is it worth the money to bring them into the P&G fold? Can they really ever move the needle? So just sort of updating us on maybe your track record with regard to the prior small acquisitions you've made. Thanks.

A - Andre Schulten {BIO 22079652 <GO>}

Yes, very good. So when we have these discussions on this, their value in integrating these small tuck-in acquisitions, we're obviously asking the exact same question. And the track record within Beauty is actually very good.

When you look at First Aid Beauty and Native as good examples, we've been able to bring these brands in, build on their existing sales basis, expand distribution, expand innovation and marketing support across channels and significantly grow both the net sales and value base. So the Beauty organization's ability to take these small brands, maintain their character and user base and apply our strength to grow them is actually very promising.

And that's the underlying hypothesis and reason why we believe these three acquisitions will create significant value for Beauty as well.

Their approach of bringing these brands in is also unique in the sense that the Beauty organization is really taking time to bring the existing organization into the P&G ecosystem, have them operate more independently than we've done in the past to ensure that the character of the brand and the key strength of the brand are maintained, and then we carefully build on top. So high confidence based on previous experience would be my summary.

A - Jon R. Moeller {BIO 16200095 <GO>}

Let me just add a couple of things here, Wendy. Our Beauty business historically has been built this way. So we acquired, for example, Old Spice. We acquired Olay. Pantene and Head & Shoulders were tiny. We're talking less than $100 million in sales and how they are two of the largest shampoos in the world. That doesn't give us any guarantee, but it's certainly, as Andre was indicating, a strong track record to build from. That's point one.

Point two, relative to the company's ability to handle M&A, and by the way, and spending time on this, I'm not suggesting that the emphasis or focus has shifted in that direction by any stretch of the imagination. The best example that I can point to, because we've had the longest track record with it, is the Merck OTC acquisition, different category, but so far, an incredibly successful acquisition. Our OTC business grew at 20% in the quarter that we just completed and is doing so very profitably.

Having said all that, probably more than any other person, and I don't mean to personalize this, I've got more blood on my back from cleaning up lots of small brands. I spent four years of my life doing it. We are going to be very disciplined, and we'll get an early read on whether we think things are going to work according to plan or not. And if not, we'll pivot.

Operator

Our next question will come from the line of Nik Modi with RBC.

Q - Sunil Modi {BIO 7557463 <GO>}

Yes. Thanks. Good morning, everyone. Just a housekeeping or a follow-up and then a broader question. On the follow-up, Andre, is there any way you can provide any quantification on the out-of-stock impacts on organic revenue growth this quarter? And then the broader question, I guess, this would be for you, Jon, is just when you think about the consumer segmentation strategy at P&G, when you think about the Gen Z consumer, do you think that you have -- the core brand set is broad enough to reach that consumer? Or do you feel like you need to either launch new brands or make some of these acquisitions that you've discussed, you've been discussing during this call to really cater to those particular consumers? Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

Nik, on the first part of the question, I can't really give you a number. It's impossible to estimate. I can give you anecdotal evidence of what we're seeing. When you think about Oral-B iO, for example, $299 toothbrush, very premium item. And obviously, we're impacted by the chip shortage just as everybody else. And we -- the demand -- the consumer demand for that product despite the price point is significantly higher than anything we can deliver. That's probably on the extreme end because for chips, there's a limited alternative -- alternatives available. But there is some impact. It's just not possible to give you a meaningful number at this point.

A - Jon R. Moeller {BIO 16200095 <GO>}

But directionally, Nik, which is what leads you to your question, there is no doubt at present that demand is stronger than supply. Andre is absolutely right. I don't know how to quantify it either. But as we address some of the opportunities, and that's how I view it, within the supply community, there should be upside beyond kind of our internal forecast and what you might expect. That's assuming, of course, that demand continues at current levels.

Relative to Gen Z consumers, and you proffered several avenues to reach and delight those consumers, I think all are on the table. There's another group of consumers that we're working to expand our coverage to. And we're, frankly, underdeveloped, and that's the multicultural consumer in the U.S. as an example. The good news is these are the same consumers. The multicultural consumer or the Gen Z population is multicultural by definition. So in terms of having a size of prize here that merits consideration of all the choices you mentioned, it's significant, and we're all over it.

Operator

Next question will come from the line of Peter Grom with UBS.

Q - Peter Grom {BIO 22424199 <GO>}

Hey. Good morning, everyone. So I was hoping to dive into the updated commodity outlook a bit. I know there are a lot of moving pieces here. And Andre, you mentioned chemicals and diesel are moving higher. But you also say that you're not really seeing relief across the other buckets. So just would be curious, like what are you seeing in commodities like pulp and resin, which seem to be trending marginally lower at least versus where we were back in September and October.

And then maybe building on that, just on the phasing of gross margin in the second half, building on Steve and Jason's questions earlier. Maybe I'm reading too much into it, but your response seems to imply that 3Q gross margin will be under pressure, but an improvement sequentially as pricing build, productivity ramps and cost pressures are in the base. And based on where things stand now, that you could return to gross margin expansion in 4Q? I know a lot can change over the next six months, but is that a fair read based on where we are today? Or are there other impacts that I'm not really thinking of that could impact that trajectory? Thanks.

A - Andre Schulten {BIO 22079652 <GO>}

Yes, to begin with the commodity guidance, within our guidance, we see a 44% increase across all commodity classes. So if you take our total basket average, it is up 44%. Chemicals up the highest now more than 60%. Resins up almost 60%. Pulp up more than 30%, et cetera. So it continues down the line. All of these numbers are in that same range.

And we see some reduction in resin prices, for example, or in pulp prices from a temporary peak. But when we look at Q2 pricing relative to a year ago, resin last quarter or quarter -- same quarter last year was $54. It's now $136. When you look about pulp, it's up more than 30%. So there is fluctuation in the short term, but the increases year-over-year continue to be very material.

From a gross margin standpoint, I'll leave it at what I've said before, we'll see sequential progress in the gross margin, driven by productivity, pricing and commodity costs coming into the base. I will not go beyond that in terms of giving a forecast. There's just too many moving pieces at this point in time. So I'll leave it at that, but we'll reiterate, we expect sequential progress.

Operator

Next, we'll come to Mark Astrachan with Stifel.

Q - Mark Astrachan {BIO 15313233 <GO>}

Thanks and good morning, everyone. I wanted to ask about the state of the consumer through the implied back half guidance. So you're going to get more pricing. Volume comparisons are easy. You raised sales guidance, but basically, the level that you had achieved in the first half of the fiscal year. So I wanted to ask what are the assumptions or what are your views of volumes and of just the general consumer outlook in your two key markets of the U.S. and of China? And maybe just to unpack it, one of the fears, I think folks have is you're going to start lapping stimulus in the U.S. Lower income consumer seems a little weaker. Does that factor into your thinking there, especially as pricing goes up? And then in China, there's obviously been lockdowns. There's Olympics. Is that any sort of the consideration as well in terms of your thinking about volume trends there and maybe a switch from traditional retail to offline or to online as well? Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

I'll start by saying the consumer continues to favor our brands, our categories. Again, daily use, essential needs of the consumer and health, hygiene and cleaning and the efficacy of our products and brands really helps us with the priority that we can provide to trade the consumer up within our portfolio. And as we take pricing, we see a lower reaction from the consumer in terms of price elasticity than what we would have seen in the past.

To give you some concrete data, in the U.S., we see on those brands where we've taken pricing in September and October, which are normally highly price-elastic. We've seen price elasticity in the range of 20% to 30% lower than what we would have expected based on historic data. So we take comfort in the strength of our brands, the broad-based growth of the portfolio globally, the broad-based growth of the portfolio across categories and the short-term reaction of the consumer as we take pricing and our ability to combine that pricing with innovation, which actually then stimulates the consumer to trade up in everything that we've seen.

We assume -- I think we hope that as some of these stimulus payments phase out, labor rate participation will increase. And hopefully, one level of income will be replaced by another, to be seen. But everything that we see at the moment, the combination of our categories being essential and relative consumer strength give us confidence for the volume growth also in the second half.

The only thing I would say on China, the element that will help us here is, hopefully with COVID easing and the regional lockdowns disappearing, that should be a positive driver of growth in China, but too early to confirm, obviously.

Operator

And our next question will come from the line of Bill Chappell with Truist.

Q - William Chappell {BIO 1737315 <GO>}

Thanks. Good morning. Thanks for taking my question. Just on the metric of 75% superiority of your portfolio, obviously, it's helped you immensely over the past few years in terms of kind of gaining market share or what have you. But I think we've been at 75% for about three, if not four years now. So just is that kind of the ceiling would be one question. Has the pandemic really slowed down your R&D pipeline kind of with trying just to fill the supply chain not wanting to roll out as many new products? Or just any color around that? Is this as good as it gets? Or can we expect that to move up to a higher number over the next few years as you kind of re-ramp up R&D? Thanks so much.

A - Andre Schulten {BIO 22079652 <GO>}

Yes, I think the numerical stability of 75% might be misleading here, because it's not static at all. Once we reach in a category, call it 80%, 90% of superiority, we reset the benchmark to ensure that we look to the next frontier in terms of where the consumer would go, what really is relevant here for the consumer.

So one example on single-unit dose, for example, we've changed the benchmark from competitive single-unit dose offering to actually test whether our tight ports are strong enough to incent consumers to trade up from liquid detergent to single-unit dose. That's the new measure. When you change that measure, the percentage decreases, which is implied and is the intent. So the strategy of superiority is really dynamic. And if we were ever to reach 99%, we would have done something wrong because we would have not looked at the external environment and as it evolves. Jon, anything you want to add here?

A - Jon R. Moeller {BIO 16200095 <GO>}

Just the point of Bill's question on innovation. We've called out many times our supply organization. Our innovation organization deserves tremendous credits. You don't contribute disproportionately to market growth across our breadth of categories and, as a result, grow share past 3, 6 and 12 months in 9 out of 10 categories without an incredible innovation capability and effort.

And one of the first things we did is we were meeting every morning, literally daily when COVID started, was to figure out what were the health protocols that would allow us to get our R&D colleagues back in the office working together, collaborating, innovating, creating superior offerings as quickly as possible. And they've -- there are certainly challenges but they have done a tremendous job of keeping this pipeline intact. And I've never felt better about our innovation capability and our ability, as Andre describes, to keep raising the bar on superiority.

Operator

Our next question will come from the line of Chris Pitcher with Redburn.

Q - Chris Pitcher {BIO 2496733 <GO>}

Thanks very much for the question. Just going back to China. Could you say, in this environment, you're seeing increased local competition rather than just a softer market and especially in reference to, say, skin, hair and fabric? And if so, whether this competition is more promotional led as you may have suggested? Or whether you're seeing an improvement in local product quality and functionality? And in the context of China looking to build its own domestic production capabilities, can you just confirm what percentage of your sales are made in the Mainland? Thanks.

A - Andre Schulten {BIO 22079652 <GO>}

Almost all of our products that are consumed in China are made in China. Local competition is strong and continues to get stronger, which is a good thing. It's a constructive force in the market. It leads to market growth and expansion. It leads to positive consumer experiences with a category or a segment, and it's something that we welcome.

I don't have specific numbers for you in terms of progress of local versus international offerings, but that's current status. And I know it's not why you asked your question, but there have been understandably a fair number of questions on China.

I would just draw your view, as Andre said earlier, importantly, at any point in time, in any quarter, we're going to have challenges. Those challenges so far haven't led to major business loss. They've led to growth slowdown in some cases, which we fully offset in other parts of the world. It's a pretty incredible feed. Sorry for the self-congratulatory tone, but I'm really congratulating the broad organization to have flat growth in a quarter in your second largest market and deliver over 6% top line growth. It really speaks to the strength of the portfolio, the strength of the strategy, which I'll come back to at the very end of this call.

Operator

And your last question will come from the line of Kaumil Gajrawala with Credit Suisse.

Q - Kaumil Gajrawala {BIO 20703548 <GO>}

Thank you everybody. Good morning. Two questions. One following up on Mark's question about the state of the consumer. Obviously, it's healthy at the moment. Your view is that it continues to stay healthy. But can you talk a little bit about any guardrails you may have in place in case that that changes quickly, in case the impact of inflation really starts to turn on impact to the consumer, obviously, the stimulus, child tax credits, these sorts of things. And then secondly, can you provide a little more detail on what pricing is going to look like outside of the United States versus domestically, specifically so that as we start to see the data coming through in the coming months? We have a good understanding of what we're seeing here and how it may compare to what's happening elsewhere. Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

Yes. I'll start. I'm sure Jon has a few points to add. On the consumer state, I think in terms of guardrails, what I'd tell you, the strongest guardrails and mitigations we have are the strength of the portfolio. We're innovating across price tiers. We are building pricing out in a way that price tiers remain accessible for the consumer, key cash outlays remain accessible. And within the portfolio that we have, depending on the strength of the consumer, they will find an offering that matches their affordability level, their cash outlay level and still give them a superior performance versus the competitive peer set.

Important to note that superiority does not mean that we're trying to trade up the consumer or trying to innovate only at the top end of the portfolio. Superiority is defined as superiority at each price tier we're competing in. So the price ladder remains intact and we innovate across, and that's probably the best protection we can offer at this point in an inflationary environment.

The pricing we take outside the U.S. is very similar to what you see in the U.S. Broad range across categories and about mid-singles is what I would tell you. In addition to that, we're taking pricing for significant FX deviation in some markets, mainly Turkey to mention, to recover short-term margin there. But broadly, I would guide you to mid-singles around the world on 60%, 70% of the portfolio, similar to what we have done.

A - Jon R. Moeller {BIO 16200095 <GO>}

So I just have a couple of closing comments. One, on pricing. Remember, pricing is an inherent part of our business model. As an innovation-centered company, we aim to create products that address better every day consumer needs and problems and can typically command some pricing while increasing the overall value proposition to consumers with those more efficacious offerings. Pricing has been a positive component of our top line for 42 out of the last 45 quarters and 17 out of the last 18 years. So while the level of pricing we're talking about here, to be fair, is typically a different level, this is not a dynamic that we're unfamiliar with. And as Andre said earlier, we certainly have significant historical and recent experience in developing markets. None of that is a guarantee but this is not new territory.

Last thing I want to leave you with, there will be bumps in this road. There will be cases where we take pricing, and we either encounter the consumer reaction that some of you are rightly looking to or a competitive reaction. There is no doubt in my mind that there will be bumps in this road. But so far, it's going very well.

Related to that, there has never been more volatility that we're having to manage across the geopolitical spectrum, the regulatory spectrum, the health spectrum, the supply spectrum, the labor spectrum. So I guarantee you, as we said in the last quarter discussion, that we will encounter sources of volatility and degrees of volatility that's sitting here today we can't imagine. That's been true each day, week and month of the last two years.

And so when you look at any one variable or one scenario, it's difficult to find relevance. My encouragement is to reflect back to strategy, portfolio ability to execute to identify those companies that will get through this the best, albeit with bumps on the road. And I think we've demonstrated thus far incredible strength of portfolio of strategy, of execution, and we're committed to keep that going.

We're here the balance of the day. John is, Andre is and don't hesitate to contact us.

A - Andre Schulten {BIO 22079652 <GO>}

Thanks, everyone. That concludes the call for today. Thank you for joining us. Have a great day.

Operator

And ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.