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Q2 2023 Earnings Call

Company Participants

- Andre Schulten, Chief Financial Officer
- Jon R. Moeller, Chairman of the Board, President and Chief Executive Officer

Other Participants

- Andrea Teixeira
- Bryan Spillane
- Callum Elliott
- Chris Pitcher
- Christopher Carey
- Dara Mohsenian
- Jason English
- Jonathan Feeney
- Kaumil Gajrawala
- Kevin Grundy
- Lauren Lieberman
- Mark Astrachan
- Olivia Tong
- Peter Grom
- Robert Ottenstein
- Stephen Powers

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.

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

Andre Schulten {BIO 22079652 <GO>}

Good morning. Joining me on the call today are Jon Moeller, Chairman of the Board, 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.

Execution of our integrated strategies continued to yield good results in the October to December quarter. Growing organic sales in 9 of 10 categories, holding global aggregate market share, continued productivity savings, improving supply sufficiency, sustained investment in superiority of our brands across all five vectors, product, package, communication, go-to-market, and value continue to pay benefits for our consumers and retail partners and in-turn for P&G shareholders. Progress against our plan fiscal year-to-date enables us to increase the guidance range for organic sales growth and maintain ranges for core EPS growth, free cash flow productivity, and cash return to shareowners.

Moving to the second quarter numbers. Organic sales grew 5%, pricing at a 10 points to sales growth, and mix was up 1 point. Volume declined 6 points, driven by a combination of market contraction, trade inventory reductions, and portfolio reduction in Russia. Growth was broad-based across business units with each of our 10 product categories, growing or holding organic sales. Personal Health Care grew high-teens, Feminine Care, Fabric Care and Home Care were up high single digits. Hair Care was up mid-single digits, Baby Care, Family Care, Oral Care and Skin and Personal Care were each up low single digits. Grooming was in line with prior year.

Focus markets grew 3% for the quarter with the U.S. up 6%. Greater China organic sales were down 7% versus prior year, as the market continued to be impacted by COVID lockdowns and weaker consumer confidence. We continue to expect a slow recovery as consumer mobility increases over the coming quarters. Long-term, we expect China to return to strong underlying growth rates.

Enterprise markets were up 14% with each of the three regions up 10% or more. Global aggregate market share was in line with prior year with 27 of our top 50 category country combinations, holding or growing share. In the U.S. all outlet value share was in line with prior year with 7 of 10 categories holding or growing share. U.S. volume share is up 0.5 versus the prior year quarter, delivering sequential improvement from quarter 1.

Recent innovations like Downy Rinse & Refresh in fabric enhancers and Dawn Powerwash in hand dishwashing, are extending superiority advantages and driving value and volume share growth. Innovation also serves as a catalyst for pricing across our other brands and forms in their category segments.

On the bottom line core earnings per share were $1.59, down 4% versus prior year. On a currency-neutral basis core EPS increased 5%. Core operating margin decreased 170 basis points primarily due to gross margin pressure from commodities and foreign exchange.

Currency neutral core operating margin decreased 70 basis points. Productivity improvements were 110 basis point help to the quarter.

Adjusted free cash flow productivity was 72% primarily due to a temporary reduction in payables. We return $4.2 billion of cash to shareowners approximately $2.2 billion in dividends and $2 billion in share repurchase. In summary considering the backdrop of a very challenging cost and operating environment, continued solid results across the top-line, bottom-line and cash for the first half of the fiscal year.

Moving on to strategy, our team continues to operate with excellence. Executing the integrated strategies that have enabled strong results over the past four years and that are the foundation for balanced growth and value creation. A portfolio of daily use products, many providing cleaning, health, and hygiene benefits and categories where performance plays a significant role in brand choice.

Ongoing commitment to and investment in irresistible superiority across the five factors of products, packaged, brand communication, retail execution and value. As discussed during our Investor Day in November, we are renewing our superiority standards to reflect the dynamic nature of this strategy.

Productivity improvement in all areas of our operations to fund investments and superiority, offset cost and currency challenges extent margins and deliver strong catch generation. An approach of constructors disruption, the willingness to change, adapt and create new trends and technologies that will shape our industry for the future, especially important in this volatile environment. Finally, an organization that is increasingly more empowered, agile and accountable with little overlap or redundancy, flowing to new demands, seamlessly reporting each other to deliver against our priorities around the world.

Going forward there are four areas, we are driving to improve the execution of the integrated strategies, Supply Chain 3.0, digital acumen, environmental sustainability and employee value equation. These are not new or separate strategies, they are necessary elements of continuing to build superiority, reduced cost to enable investment and value creation and to further strengthen our organization. We expanded on each of these at our Investor Day in November, if you weren't able to attend or listening remotely, I encourage you to review the materials on our IR events website.

Our strategic choices on portfolios, to priority, productivity, constructive disruption and organization are interdependent strategies, they reinforce and build on each other, when executed well they grow markets which in turn grow share, sales and profit.

We continue to believe that the best path forward to deliver sustainable top and bottom line growth is to double down on these integrated strategies, starting with commitment to deliver irresistible superior propositions to consumers and retail partners.

Now, moving to guidance. We continue to expect more volatility and costs, currencies and consumer dynamics as we move through the second half of the fiscal year. However, we

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think the strategies we've chosen, the investments we've made and the focus on execution excellence has positioned us well to manage through this volatility over time.

Raw impact material costs inclusive of commodities and supplier inflation are still a significant headwind versus last fiscal year, though we have seen some modest sequential improvement. Based on current spot prices and latest contracts, we now estimate a $2.3 billion after-tax headwind in fiscal '23.

Foreign exchange is also a significant year-on-year headwind, but like raw and pack materials, we've seen modest direction of improvement. Based on current exchange rates, we now forecast a $1.2 billion after-tax impact for the fiscal year.

Freight costs to remain higher versus prior year as we continue to expect the $200 million after-tax headwind in fiscal '23. Combined headwinds from these items are now estimated at approximately $3.7 billion after-tax, $1.50 per share, a 26 percentage point headwind to EPS growth for the year. For perspective recall that we began the year expecting approximately $1.33 of cost and FX headwinds. So despite some modest relief since last quarter, our current outlook is still $0.17 worse than our in going position.

We are setting a portion of these cost headwinds with price increases and productivity savings. We are continuing to invest in irresistible superiority, and we are investing to improve our supply capacity, resilience and flexibility.

As we said before, we believe this is a bottom-line rough patch to grow through with continued investment in the business and underlying strategies. As I noted at the outset, our solid first half results enable us to raise our organic sales outlook and confirm our guidance ranges on EPS and cash.

We are increasing our guidance for organic sales growth from a range of 3% to 5% to a range of 4% to 5%. Within this company wide range, we -- there are many puts and takes. As I mentioned we expect to see some modest improvement in China, but European markets have softened as high inflation affects consumer spending. The U.S. remains relatively strong to date and most enterprise markets remain resilient.

On the bottom line we're maintaining our outlook of core earnings per share growth in the range of in line to plus 4% versus the prior year. The significant headwinds from input costs and foreign exchange keep our current expectations towards the lower end of this range. This guidance also reflects our intent to remain fully invested to drive our superiority strategy and increase investments as opportunities are available.

We continue to forecast adjusted free cash flow productivity of 90%. We expect to pay around $9 billion of dividends and to repurchase $6 billion to $8 billion of common stock. Combined a plan to return $15 billion to $17 billion of cash to shareowners this fiscal year. This outlook is based on current market growth, rate estimates, commodity prices, and foreign exchange rates. Significant additional currency weakness, commodity cost increases, geopolitical disruptions, major production stoppages or store closures are not anticipated within these guidance ranges.

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To conclude, we continue to face high year-over-year commodity and transportation costs, inflation in the upstream supply chain, and in our own operations, headwinds from foreign exchange, geopolitical issues, COVID disruptions impacting consumer confidence, and historically high inflation impacting consumer budgets. These macro economic and market level consumer challenges we're facing are not unique to P&G, and we won't be immune to the impact. We attempt to be realistic about these impacts in our guidance and transparent in our commentary.

As we said before, we believe this is a rough patch to grow through, not a reason to reduce investment in the long-term health of the business, we're doubling down on the strategy that has been working well and is delivering strong results. We continue to step forward towards our opportunities, and we remain fully invested in our business. We are committed to driving productivity, improvements to fund growth investments, mitigate input cost challenges, and to deliver balance top and bottom-line growth.

With that, we're happy to take your questions.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) Your first question comes from Dara Mohsenian of Morgan Stanley. Please go ahead.

Q - Dara Mohsenian {BIO 3017577 <GO>}

Hey, guys, good morning.

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

Good morning, Dara.

Q - Dara Mohsenian {BIO 3017577 <GO>}

So just a couple of questions on the full year guidance. Obviously, you didn't change the earnings guidance despite FX and commodities each being a little less negative than you originally thought. Is that more sort of making up for some of the sequential moves that we saw in Q1? Is it more you assuming reinvestment in the back half? Or is there something else in the back half? Just help us understand the reasoning there.

And basically, the same question on top line. I don't want to get into a 10-part question, but there's a bunch of sort of back and forth here. You raised the low end of the full year org sales range, but Q2 decelerated a bit versus Q1, in the back half in theory implies a deceleration and volumes were a little weaker in the quarter. So maybe just taking a step back, how do you feel about the business in terms of looking at retail takeaway in fiscal Q2 and thoughts on the back half of the year? Thanks.

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A - Andre Schulten {BIO 22079652 <GO>}

All right. I'll give it a try, Dara. So -- on the total year forecast, I think we have one results in, we are on track, very well on track to deliver the year and the guidance ranges that we're communicating. When you look at our EPS delivery for the balance of the year, we are assuming, as we always do, current spot rates on commodities and foreign exchange. And given our desire to reinvest, we would not assume that every dollar that we see in commodities and foreign exchange immediately flows through to the bottom line.

We see significant upside for us to continue to invest in superiority across all five vectors. And if that upside is available to us, we will do that in the short term and the midterm.

We have -- also, as we said in the prepared remarks, we are still above ingoing assumptions. So $0.17 worse than we had at the time when we provided the initial guidance, so that leads us to continue to be pointed towards the lower end of the core EPS range. But as you say, with more help coming, that probably is increasing our confidence to deliver that range or hopefully slightly better.

On the top line, again, when we look at the half 1 results, we feel very good about our standing here to deliver a higher -- the higher end of our initial top line guidance. So that's why we raised to 4% to 5% organic sales growth. And the fact that we see low volumes in the current quarter really is important to understand in more depth.

So the 6% or 5.8% negative volume on the quarter, when you dissected about half of that is not really consumption-driven. So we have a point related to our portfolio choice in Russia, where we cut the portfolio by 50% to focus on essentials versus the full portfolio we were operating before. We have about 2 points related to temporary inventory reductions, which we saw in China with the market heavily impacted by COVID lockdowns and O&D. And especially on the offline side of the market, we see retailer inventories reduced reserve cash.

We saw some inventory reduction in power Oral Care and Appliances in Europe. And we have seen in late December, very strong consumption in the U.S., where retail orders haven't quite kept up with that consumption.

So if you strip that out, the actual consumption-related volume decline is about 3% on the quarter, which is in line with what we've seen in quarter 1, which is in line with our expectation and elasticities that we would have expected, given the amount of pricing that is in the market.

What is encouraging to us to raise the top line guidance is that our volume shares are holding globally, our value shares are holding globally. And when we look at the U.S., our biggest and most important market, we actually see an acceleration of volume share by 50 basis points over the past three months and even 80 basis points over the past one month. Again, all of that gives us confidence to raise the top line guidance while we want to preserve the flexibility to continue to invest in superiority to drive more sustainable growth.

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And honestly, that's going to be our job here over the next few quarters, continue to drive household penetration to reinvigorate overall volume growth in the category.

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

Hey, Dara, this is Jon. I would just add a couple of pieces of perspective at a macro level. The world seems to want everything to be better as do I. That's really not reality though. There's an incredible amount of uncertainty that remains. None of us, I think, globally really understand what the recovery rate in China is going to be as an example.

And nobody really understands what the new policies and practices are going to mean in terms of consumer confidence in that context, have the war in Eastern Europe, you have the highest inflation rates in 40 years. You have continued volatility in both the currency markets and the commodity markets. And importantly, that currency exposure for us is not a simple dollar exposure. There's a lot of cross rate exposures within that, which I realize makes it difficult to penetrate.

But for example, the cross rate between the British pound and the euro, has a significant impact on our bottom line. So all that put together, while I'm extremely happy with the progress the organization is making, I'm extremely confident that the strategy that we have is the right one that's going to continue to serve us well. It's just not an easy time to be taking up guidance to the top range of possibility.

Operator

The next question comes from Lauren Lieberman of Barclays. Please go ahead.

Q - Lauren Lieberman {BIO 4832525 <GO>}

Great, thanks. You covered a lot in that answer. So I'm going to switch gears a little bit and maybe talk about capacity investments. I think one of the big drag to gross margin this quarter was this capacity investments. I know there had been some particular areas like Fem Care, Oral is a big focus. So if you could talk a little bit maybe about anything Fem Care, beyond Fem Care where you're putting incremental capacity in to what degree you expect that to remain a drag to profitability over the next couple of quarters? Or is it a multiple year dynamic? Because that would also speak to some pretty healthy expectations around longer-term volume trends. And I think that's particularly relevant also as we look a little bit beyond the next quarter or two. Thanks.

A - Andre Schulten {BIO 22079652 <GO>}

Yes. Hi, Lauren. We are -- the short-term effect that we are describing here is indeed Fem Care related. We see on the top end of the portfolio, very strong growth. We have seen very strong growth over the past two years. And we are just need to catch up in terms of overall capacity to demand ratio, both on the top end of our pads business, which is the Radiant or Infinity business. And as you well know, we're still not up to full demand levels on tampons, which we will install -- are in the process of installing new capacity in the back half.

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The investment across businesses to catch up to the very significant increase in terms of business size is underway. So we have capacity investments across most businesses. I wouldn't expect it to be a significant drag on the bottom line. In fact, the growth that we anticipate will more than outweigh the cost of investing in capacity, and that's the plan, obviously.

So we have high confidence in our growth potential and that's really what's triggering these capacity investments. Just in the U.S., for example, the last quarter was the first quarter we've reached $40 billion in sales, up from $30 billion in sales just four years ago. So -- and again, our growth rate continues to look very positive. Volume shares are up and better than the market, our volumes are trending to positive numbers year-over-year. So we need to keep up with that. The net of it is all positive.

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

Yes. Just one quick clarification there. The $40 billion that Andre is referring to is a annualized or a run rate number. So it was $10 billion in the quarter, which translates to $40 billion over four, just so people don't get too carried away

Q - Lauren Lieberman {BIO 4832525 <GO>}

Fair enough.

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

Lauren, the point that you made and the point Andre made, there's a lot of upside here as we bring this capacity online. We indicated we're not meeting full demand in some of the feminine protection segments. We have opportunity, as you said, across the board. So we're investing pretty significantly. I think as he said and you've said, the bigger impact will be in our ability to accelerate the top line, which should not be significant bottom line drag.

Operator

The next question comes from Bryan Spillane of Bank of America. Please go ahead.

Q - Bryan Spillane {BIO 2147799 <GO>}

Thanks, operator. Good morning, everybody. I just -- I had one clarification and one question. The clarification, just I think in response to Dara's question, you cited 3 point hit the volume from basically Russia and shipping behind consumption. So if we add that back, organic sales would have been closer to an 8% versus a 5%. I just want to make sure that, that was the way we should be thinking about it?

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A - Andre Schulten {BIO 22079652 <GO>}

That's correct.

Q - Bryan Spillane {BIO 2147799 <GO>}

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Okay. Thank you. And then as we look into the back half of the year, I guess, just if you could comment on two things. One is, has anything changed in terms of your view of the macro setup? So just as the operating environment the same, better or worse than what you were expecting? And then also, just would we expect maybe to rebuild some of the inventory, the under shipment that occurred in the second quarter or the first half, would we get any of that back in the second half?

A - Andre Schulten {BIO 22079652 <GO>}

I would say the operating environment continues to be difficult, and we expect it to be difficult in the second half. While I think the U.S. is holding up very well. Enterprise markets are holding up very well. As Jon said earlier, recovery in China will be very hard to predict and probably not a straight line. So we expect China to be difficult in the second half as it was in the first half.

The European markets will continue to have to work through very high inflation numbers. I think we've seen a little bit of help via a warmer winter season that has helped energy prices. But Europe is not through, I think, inflationary pressures and consumers are still to see many of the consequences in terms of their heating bills as we are entering February and March. That doesn't change anything we do. I think the best way for us to get through all of this is to continue to invest in the business and to continue to execute with excellence, which the organization is doing and which is driving these good results.

Our ability to carefully balance pricing and productivity to offset the inflationary pressures is critical. Within pricing, careful execution and combining pricing with innovation and sufficient investment to drive superiority of our brands is critical. So that's why we want to preserve some level of flexibility to do those investments as we get through the second half.

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

Just a little bit of color on the inventory piece, which has been accurately described a couple of times here. This is a fairly simple dynamic that's occurring. When there is supply volatility and uncertainty, it causes retailers to build higher inventory levels. When there's demand volatility, it does the same. So we've been through a period where inventories have been a little bit higher than normal in some of our retail channels. Supply assurance is increasing, demand volatility is decreasing. So those inventories are understandably being brought down. And so Bryan, I don't expect that there's a significant swing here quarter-to-quarter. I think this is the system normalizing itself.

A - Andre Schulten {BIO 22079652 <GO>}

Yes. I think Jon is exactly right. Our on-shelf availability is getting better. We're up now to 95% on-shelf availability, up from 93%. We make sequential progress. So as the supply chain is stabilizing, I wouldn't expect immediate return of those days on hand. I think some of it will come back, but it will take a longer period of time.

Operator

The next question comes from Stephen Powers of Deutsche Bank. Please go ahead.

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Q - Stephen Powers {BIO 20734688 <GO>}

Yeah, yes. Hey, good morning. Thanks. I wanted to go back just to the topic of reinvestment for a minute. It was a big topic last quarter, and I think you convinced us then and through your commentary at Investor Day that you were actually pretty fully invested in your prior outlook enabled by productivity. So as you think about the reinvestment that you're implying incrementally in the new outlook. I'm just -- is that -- should we interpret that as elective and opportunistic for kind of greater medium-term returns? Or is it more necessary in the near term given more concerning consumer competitive realists? Just how you'd frame that reinvestment would be helpful.

And then if you could also just -- you talked about strength in the enterprise markets, your resilience. So just is there any pockets of particular strength you could call out, that would be great. And any areas where you're more watchful, that would also be helpful. Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

I would characterize our current media spending and support spending for our brands as sufficient, which we are paying a lot of attention with each of the businesses. Jon pays a lot of attention with each of the businesses to ensure that is the case. And sufficiency is defined as sufficient reach, sufficient frequency. It's not defined as dollars spent. So again, I want to come back to the fact that, yes, we view the current business as fully funded, sufficiently funded in order to continue growing our brands, their top-of-mind awareness and their equity.

When we reinvest, we reinvest because there is a positive return in the short term, and we can further strengthen our brands or specific innovation that is out there. In the most recent quarter, for example, we've increased quarter-over-quarter, our total ad spend by $140 million. And that is a function of innovation timing. It's also a function of merchandising support and core timing advertising with that retailer support. So we --you see us adhere to that principle of fully supporting our brands if there are opportunities to create short-term ROI will continue to double down.

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

And one other opportunity that we've talked about a little bit this morning, as additional supply comes online, there are often opportunities to increase support for the business to take advantage of that additional capacity. So we'll be looking for those, as Andre said, positive ROI opportunities to drive the business.

You asked about enterprise markets. When you get down to a country level, of course, it's very variable. But 14% growth on the top line, all three regions growing at over 10%. So the strength is pretty broad there.

A - Andre Schulten {BIO 22079652 <GO>}

Yes. And if you look at LA, 21% growth, for example, so that will be the top end of the growth and fairly consistent here. So enterprise markets continue to deliver very strong results.

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Last point, maybe on the media investment, the synergies we're able to create are a real and not insignificant. So if you look at Baby Care, for example, that business has grown 10% last year. They have completely shifted the way they run their media. They've increased reach by 20%, increase top-of-mind awareness by 26%. All of that while they saved 15% of their media spend. So the equation here really allows for sufficiency at lower cost.

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

And that, again, just for clarity, is a U.S. dynamic that Andre has just described, the 10% growth. I'll leave it there.

Operator

The next question comes from Olivia Tong of Raymond James. Please go ahead.

Q - Olivia Tong {BIO 22252574 <GO>}

Great. Thank you. If memory serves me right, much of the pricing actions from last year will start to lap in the March quarter. So in your view, is the December quarter, the one that has the biggest spread between price and volume? And could you talk about where your elasticity stand relative to historical view? And if -- and how price and volume tracked at the end of the quarter versus the minus 6% versus plus 10 average for the quarter? Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

Hey, Olivia. The -- let me start with elasticities. The overall view has not changed. We continue to see more favorable elasticities than we would have expected on historical data pretty much everywhere, but Europe focused markets. And you can see with 10% pricing flowing through. And when you strip out the non-consumption-related volume effect, a 3% reduction in volume, that is a very benign elasticity that we're seeing in aggregate and allows us to hold volume share and value share as the pricing flows through.

So we feel good about, again, the strategy, doing what we wanted to do and the execution being very diligent in each of the markets.

Europe is the one place where elasticities have returned to what we would have expected more on historical data, and that is driven by the increased pressure on the consumer. We're also seeing a little bit of price lag here. So private label, for example, is pricing slower in Europe, and that increases temporarily the price gap versus private label. Nothing we didn't plan on, but that explains part of the higher elasticities.

In terms of peak pricing, you're right, many of the large price increases get left this fiscal year. But that doesn't mean that we're not putting more pricing in the market. So for example, we have a number of price increases that go into effect in February. So there's two components here. One where lapping price increases were executed last year, but we're also still passing through some of the cost pressures via incremental pricing around the world.

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Operator

The next question comes from Chris Carey of Wells Fargo Securities. Please go ahead.

Q - Christopher Carey {BIO 21810941 <GO>}

Hi. Good morning.

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

Good morning, Chris.

Q - Christopher Carey {BIO 21810941 <GO>}

I just wanted to come back to Steve's question on investment priorities. If I take your fiscal year outlook, you're clearly implying better margins in the back half of the year. But if I just walk through a gross margin bridge of what perhaps makes sense, it does seem to imply you'll need to see leverage on the SG&A line in the back half of the year to drive margin expansion potentially notable SG&A leverage despite sales decelerating. So again, if you could just help me frame overall SG&A and whether you think you'll be ending the year with appropriate levels of spending? Or if you expect investments to maybe grow progressively over the next 12 to 18 months as, for example, your capacity continues to improve, as Jon just said.

A - Andre Schulten {BIO 22079652 <GO>}

I wouldn't expect a structural shift in SG&A spend. I think what you're seeing in the run rate is about what we expect to need in order to be sufficiently funded and the gross margin -- and most of the margin expansion will come from gross margin expansion as we ramp up productivity, pricing continues to flow through and that builds gross margin period-over-period. So that will be the bigger contributor. And we're not counting on any major reductions in SG&A beyond what productivity allows us to deliver again, at current sufficiency levels, and we are very carefully looking at what can we reinvest actually and still deliver within the range that we want to deliver.

Operator

The next question comes from Kaumil Gajrawala of Credit Suisse. Please go ahead.

Q - Kaumil Gajrawala {BIO 20703548 <GO>}

Hi, everybody. Good morning. your commentary, I guess, just now on taking further pricing, it's obviously appropriate given we have a series of costs that are still coming through. But can you maybe just talk a little bit about the response from retailers and is that changing in any way? Not that long ago, it seemed across all of CPG, it was maybe easier to get some pricing through. And I'm just curious if that's changing in any way.

A - Andre Schulten {BIO 22079652 <GO>}

Yes Good morning, Kaumil. The environment continues to be constructive. We don't see much change in retailer conversations. It's focused on how do we best play the role that

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we need to play as a category leader in many of the markets by combining pricing with innovation, executing pricing in a way that consumers can appropriately choose from different price points, different value tiers. And how that plays out at retail shelf, both virtual and physical shelves in the best possible way, so we can help them grow their category grow foot traffic, et cetera. Those are really the majority of the conversations.

I would characterize this quarter or next quarter as any different than the previous quarters, where really it's about how do we do this, when is the best time to execute. It's not should we or must we take pricing. I think everybody still understands that we are recovering costs after we recover as much as we can with productivity.

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

And as Andre said, the conversation much more constructive, we're all concerned when we focus on improving consumer value holistically defined. And that's exactly what Andre was talking about in terms of the combination of innovation and pricing. And when that's the conversation, it takes on a very different nature than a more transactional discussion.

Also don't forget, our retail partners are the owners of the private label brands that we compete against. They're facing many of the same dynamics in terms of their cost inputs that we are. So just to reconfirm what Andre said, it's been a generally constructive discussion. I don't see anything in my interactions with our retail partners that causes an inflection in that discussion in the near term.

Operator

The next question comes from Robert Ottenstein of Evercore ISI. Please go ahead.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great, thank you very much. Just first, a quick follow-up and then my main question. So one, in terms of follow-up, is the volume headwind in this quarter from Russia and sort of the one-offs? Is that just a quarter issue? Or is that going to linger on to the following quarters? And then my primary focus is the market share data that you gave us in terms of the U.S., I think, was very impressive, particularly given some of the lingering supply issues that are going to be resolved soon. So can we expect perhaps accelerating improvement in market share as the year goes and the supply comes on and maybe give us a little bit more sense of what the drivers were for the encouraging market share momentum in the U.S.? Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

Yes. Robert, on the volume side, I think the Russia effect will be with us for one more quarter before we annualize. And on the inventory side, as we said before, we believe this was a onetime adjustment. I wouldn't expect this to come back immediately. I wouldn't expect a significant further reduction in inventory.

When we look at the U.S., for example, where we have good data in terms of retailer days on hand, we believe we are at pre-COVID levels, which is about the level that we've

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proven to operate reliably with our retail partners. So I would expect that to be a one-timer with potentially some help coming in back over the next few quarters.

The volume share dynamic in the U.S. is driven largely by Fabric Care coming back into supply. We have talked in the fourth quarter of last fiscal year and also in the first quarter of this fiscal year, that we had some supply constraints on our Fabric Care business that we had to address. We also reinstated merchandising support in the U.S. We've reinstated media support and that is playing out in volume share accelerating on the Fabric Care business.

The other dynamic is family care sequentially improving from a volume share standpoint where we have seen a very high base when private label was in less supply and didn't have merchandising in the July to December period of last calendar year. That is being annualized. So those two will continue, hopefully, to be a tailwind to our share position in the U.S. But as Jon said, it's hard to predict and look around the corner here, there are many, many variables that we don't control, but those two businesses explain the strength and hopefully, should have more upside going forward.

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

And just one attempt at changing maybe a little bit some of the semantics from supply issue to supply opportunity. Our supply organization has done a terrific job. If you look at the last 15 quarters or so, our organic sales -- the amount of organic sales end of period to beginning of the period is up 80%, 90%, which is a really good thing. And they've done a tremendous job of trying to keep pace with that. And as we talked about, there's just additional upside to fully meet and satisfy that, that demand.

Operator

The next question comes from Peter Grom from UBS. Please go ahead.

Q - Peter Grom {BIO 22424199 <GO>}

Thanks, operator, and good morning, everyone. I hope you're doing well. So I wanted to ask about the change in the commodity outlook, which for the first time in quite some time, the outlook has actually moved lower sequentially, understanding that there's a lot of moving pieces, but can you just help us understand what's driving that? Is it broad-based? Or are there particular inputs where you're starting to see inflation moderate more substantially? Thanks.

A - Andre Schulten {BIO 22079652 <GO>}

Good morning, Peter. It really varies period-over-period, month-over-month. We've seen pulp was holding relatively steady. It has come down a little bit now on different grades. Propylene, polyethylene has come down a little bit. But it's really broad based and it's changing month-over-month, week-over-week. In general, what we're seeing is, as you would have known, the supply situation is easing a little bit, and that's obviously helping the market dynamic, both on commodities as well as on transportation and warehousing.

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There's no guarantee that, that will continue. We don't know what China reopening will do to the commodity market. That's a significant variable that nobody really understands at this point, I would argue. So we're watching this closely, and we continue to forecast based on what we know today, which is spot prices.

I think the other dynamic we can't forget is that our suppliers are still working through their input cost inflation, their labor inflation, their energy cost inflation. So there are two opposing forces here. One is the desire of our suppliers as contracts roll over to pass that through to us. And the other one is input costs easing in the short term. So we have to take both into account when we think about our ability to pass through cost helps.

Operator

The next question comes from Andrea Teixeira of JP Morgan. Please go ahead.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Thank you. Good morning. I have a clarification and a question. Andrea, in your response about the destocking that should be over in the next quarter, is that also applicable for China? And how are you seeing China consumption rebounding as you exit the port and obviously, with the reopening? And if I can squeeze up your question, can you comment on how you're preparing your portfolio in Europe for potential recession. As you called out, things may, the bills -- energy bills may be kicking out -- kicking up now as we enter your third quarter fiscal. Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

Hey, Andrea. Yes, the China destocking, I think, will largely depend on the China reopening and that's very hard to predict. I think if consumer mobility returns to normal levels quickly, that will be a tailwind for every retailer with real estate on the ground. And that's really the major issue that off-line retail is facing. So if traffic returns to normal levels, that will be a big help, and obviously, no further destocking required. I'll leave it at that because I have no good way of knowing not as anybody else.

We expect consumption in China to reaccelerate to mid-single digits over what period is hard to predict. But in the midterm, that's where we see our China market and it continues to be an important investment market for us. We have a very capable organization on the ground, and they are spending their days and nights to get ready for that. Fine-tune our innovation, ensure we have the best possible marketing programs, both digitally and with our retail partners on the ground.

I think on the European portfolio, we have prepared, like everywhere else, our portfolio for a recession. And it comes back to the basic strategies on the categories we play in. We are in non-discretionary categories to a large degree that people won't deselect easily. They continue to watch their laundry, they continue to wash their hair. So that's number one for recession proving our business model.

Step number two is investment in irresistible superiority. When consumers see the benefit our brands can deliver, the value will be clear to them and our ability to communicate that

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value clearly is critical, and that's why we continue to invest in both the performance as well as the communication.

And then the last part is just accessibility of the portfolio, both in terms of brand tiering, so having premium brands but also value brands and price points across different channels, be that discounters or other retailers. So I think the portfolio proofing has been done, and I think it's showing results in a very difficult environment that we think speak to the strength of the strategy.

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Operator

The next question comes from Kevin Grundy of Jefferies. Please go ahead.

Q - Kevin Grundy {BIO 16423871 <GO>}

Hey, thanks. Good morning, everyone. We've covered a lot of ground. I want to try to connect the dots here on the 8% organic sales growth if we exclude the items that Andre called out, with comments in the press release around market contraction. So in the release, you mentioned market contractions in Hair Care, Grooming, Fabric Care, Baby Care, Family Care, across much of the portfolio. But as Andre talked about, the org sales in the quarter was closer to 8%. And if we look at the comp, it was actually an acceleration on a two-year stack basis.

So what I really want to do is just -- I know we've covered a lot of ground on this call, just to make sure I'm kind of clear on how you're seeing category growth, how you're seeing elasticities and consumer behavior coming out of the quarter. Because it seems to me that the quarter is actually on a like-for-like basis, possibly even better than the Street had modeled. And setting aside China, you sound pretty constructive on demand dynamics. You sound pretty good on elasticity sort of relatively unchanged. And I just want to make sure that's the messaging for investors. So thanks for all that.

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A - Andre Schulten {BIO 22079652 <GO>}

Yes. And I would characterize, obviously, the Russia element will be with us, and that's real. I think the market growth has been around 5% to 6% with a negative volume component and a very positive price component. I would expect that in the midterm to moderate to 3% to 4% overall growth and still have a negative volume component with offset by strong pricing that we continue to flow through the market.

If you look at overall market size over the past three months, that has been the case, and that's where we expect it to be going forward. And that's pretty much in line with how we model the balance of the -- balance of the fiscal year. Our job here is to be ahead of that. And that's why we're investing that we will continue to double down on superiority investments everywhere. Jon, I don't know if you have anything to add.

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

Yes. It's a repeat, but it's worth repeating. It's a bit of a rain drop on the fray, Kevin. But I just want to highlight so that we don't get ahead of ourselves, how uncertain, for example,

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China is. Andre said it several times, we don't have visibility.

We have, within our own operations, offices, innovation centers, plants, our current estimate of the infection rate is up to 80%. And we're sitting here in the week before Chinese New Year when all the traveling occurs. At the same time, we have a government and a populist who desperately wants things to get better. It's just very hard to say, hey, we should assume that as we go forward, China comes back like a tiger [ph]. Certainly, we all hope that's true. I hope for China, that's true. But just you really need to understand how uncertain things are.

Operator

The next question comes from Mark Astrachan of Stifel. Please go ahead.

Q - Mark Astrachan {BIO 15313233 <GO>}

Yeah, thanks, and good morning, everyone. I wanted to move from that rain drop question to a bit more funny question and just ask about whether the resilience of the U.S. consumer has surprised you all sort of what's embedded in guidance from here? I know what you said, Andre, about the category, but that was, I think, on a global basis. So how do you generally think about U.S. trends from here? And within the portfolio, have there been any surprises relative to historical expectations, meaning things that have performed better than you would have expected? And kind of what are you watching from here from a portfolio standpoint, all within the context of the U.S. business?

A - Andre Schulten {BIO 22079652 <GO>}

Yes. Good morning, Mark. I wouldn't expect the U.S. to fundamentally change. If you look back over the past six months, private label shares in the U.S. have been relatively steady. We've seen 20 basis points to 30 basis points of increase in private label share, which is a metric we're watching closely. But if you look at sequential share, absolute shares of private label, it continues to hover around 16%, past 3, 6 and even 12 months.

So there hasn't been a significant shift in consumer behavior in terms of trade down. I think the way that our pricing was executed with great support in innovation and great support in terms of marketing spend has helped. Our strategy isn't shifting. I don't see the market shifting significantly. All of that with a caveat that who knows what the next six months are going to bring.

But if past behavior over the last six months, nine months is any indication, I think the consumer is relatively steady in the U.S., which gives us great confidence. It's our biggest market. We do well, expanding volume share, as I said, and hopefully have a bit more upside here as Family Care and Fabric Care continue to gain momentum.

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

And this continues to be a market, the U.S. market that is very responsive and a positive way to innovation that improves performance, both for the product and the package. And we have many examples Dawn Powerwash as an example, introduced at a premium price.

The brand has grown at 50% since that introduction and Dawn has driven 90% of category growth in that situation. Dawn Powerwash, again, a premium priced item that was introduced largely during difficult economic times as a stand-alone brand would be the third largest brand of the category. So I just used that as an example for the continued positive responsiveness of U.S. consumers to innovation, and we've got a lot of innovation coming.

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Operator

The next question comes from Callum Elliott of Bernstein. Please go ahead.

Q - Callum Elliott {BIO 20826092 <GO>}

Great. Thank you very much for the question. I wanted to come back, please, to the brand spend dynamic. And Andrea, I think the example you gave to Baby Care is quite powerful. If you can increase so meaningfully while simultaneously cutting dollar spend. I guess that's probably driven by digital and better targeting there versus traditional media.

My question is, do you think these benefits are sustainable or over the longer term, are we not likely to see some of these digital ROIs come back down as digital ad pricing goes up and some of your competitors start to catch up with new capabilities there?

A - Andre Schulten {BIO 22079652 <GO>}

I believe -- we believe that we're just at the beginning actually of our productivity curve. And it's driven by two things. I think Baby Care was one of the -- U.S. Baby Care one of the more aggressive ones and one of the more obvious ones when you think about the consumer target, it's very narrow, right? You're looking for households with babies and diapering age. So going from mass TV where you have a lot of waste hitting that target, which is about 3% to 4% of the population, provided the most obvious opportunity to drive synergies here.

But we've learned also in other businesses, the opposite works. When you think about Fabric Care, everybody is doing laundry. So you've got a very wide target that you need to reach. And the Fabric Care team in the U.S. has brought their media planning and buying in-house, developing proprietary algorithms to better place ads during the TV programming, for example. And that in and of itself has allowed $65 million of savings in one year, while increasing frequency.

So both models work and both models are still not everywhere. So we've got two examples in the U.S. There are many categories in the U.S. that are still building their own approach to drive these synergies and there's the whole world outside of the U.S., which is still building on the capabilities that we are developing. So we see this as a area of continued investment in terms of our own capabilities with a great ability to drive productivity for years to come.

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Operator

The next question comes from Chris Pitcher of Redburn. Please go ahead.

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Q - Chris Pitcher {BIO 2496733 <GO>}

Thank you very much. Apologies for carrying on the inventories question. But Jon, you mentioned you were looking at a normalization. But in the Investor Day, you showed obviously a significant improvement in your supply chain efficiency. Do you think you're in the position over the next couple of years where U.S. retailers could operate at even lower inventories and improving your relationship with them is working capital part of the conversation that you have with them in sort of helping form share of shelf?

And then thank you for the color on the international business. Could you share with how fast your Indian business grew in the period because it looks like the India consumer there is recovering and whether you're seeing a sustained double-digit recovery there as well? Thank you.

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

Thanks for the question. I do think that there's a significant opportunity for the entire supply system to operate at lower levels of inventory. And one of the enablers there in addition to supply dependability is increasingly looking at the supply chain across -- we historically looked at it as our supply chain and our customer supply chain as we're beginning to have conversations about this was one supply chain, would we do things differently? And the answer is almost yes. And the opportunities that are resident within that discussion are significant.

So I do think we will continue to have that conversation and try to make progress in a way that benefits both ourselves and our retail partners and ultimately the consumer with higher on-shelf availability. And then go ahead, Andre, you want to talk about India?

A - Andre Schulten {BIO 22079652 <GO>}

Yes, sure. The India business continues to accelerate. We saw Q1 growing 12% organic sales, Q2 13%. And India is a good example of those capabilities that we were just talking about actually rolling out and being very effective. So the digital infrastructure we've been able -- the team has been able to create in India is quite impressive and that's contributing to our ability to drive disproportionate growth there, both from a sales capability standpoint and from a media capability standpoint.

Operator

The next question comes from Jason English of Goldman Sachs. Please go ahead.

Q - Jason English {BIO 16418106 <GO>}

Hey. Good morning folks. Thanks for sliding me in, and congrats on that sales milestone and the market share progression this quarter. I've got -- I'm going to cheat and like many, jam a few questions into one. So first, what geographies are you taking the majority of the incremental pricing in? Second, you're signaling more reinvestment on the comp as supply improves, what shape do you expect it to take, i.e., product, advertising promo, et cetera?

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And lastly, I don't know if I should read much into this, but you've made substantially more references to volume share rather than value share this quarter. Does this reflect a shift in prioritization and focus for you? Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

Thanks, Jason. On the geographies, I would not see any disproportionate tilt towards one or the other. If you look at the cost structure, the implications, they are pretty similar across the different regions. Timing might shift. Category is, obviously, shifting.

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

Yes. There's one exception to that, agree totally as it relates to pricing, related to commodities. But there are some markets, of course, where currencies are devaluating massively.

A - Andre Schulten {BIO 22079652 <GO>}

Right.

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

And there is where you see our highest amount of pricing take Argentina, Turkey, the usual suspects.

A - Andre Schulten {BIO 22079652 <GO>}

Correct. So if you look at the enterprise market, this would generally take higher pricing in line with overall inflation in the market. So to Jon's point, that will be -- that will continue to be the case. There are other markets where pricing is notoriously more difficult to think about Japan, think about the G7 in general. So that's where you see less pricing impact. But that's not different from what we would have seen over the past few quarters.

Look, our desire to reinvest is across all vectors of superiority. So it is product package innovation. It's in communication, it's in go-to-market execution. So all of those are relevant. They differ by region, by category, obviously. The reason why we're focusing more on volume share is we believe that it is our job and opportunity to continue to drive penetration of our brands. We have a huge runway when you think about our ability to continue to drive consumption and even the most developed categories.

So we want to focus our team on driving -- continue to drive household penetration, continue to create jobs to be done, continue to drive consumption opportunities. A world in which all of the market growth is driven by pricing is obviously not sustainable. And so both elements need to come back in balance, and that's why you see us talk both elements here between value and volume share.

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

Just for clarity on this point, though, I am not interested in volume share at the expense of value share. Volume share is a way to deliver value share. So at least we not be clear, it's both that are important, not a shift in emphasis between one or the other.

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The other reason that I wanted to make sure that we talked a little bit about volume is that it's a natural concern when we're taking this pricing as to how your volume is holding up and how -- particularly how's your volume share holding up. So we just wanted to be transparent on how we're seeing it, which is very attractive so far.

Operator

The final question comes from Jonathan Feeney from Consumer Edge. Please go ahead.

Q - Jonathan Feeney {BIO 2268157 <GO>}

Good morning, and thanks very much. I want to ask a simple question that's really complicated. When you look -- when you talk -- at the time you gave us the initial commodity guidance for the fiscal year '23, rough numbers, U.S.-based spot costs for freight and energy composite for your company, it was down something like 9% since then. And you have lowered your expectation for commodity inflation.

Simple question is, can you -- are your experience costs for this quarter below their peak? Like I see the year-over-year was 380 basis points of cost push headwind to gross margin versus 510 basis points last quarter. So there's a -- can you confirm there's been a sequential step down?

And secondly, could you in what quarter would we expect costs to no longer be a headwind like be all in the base? Would that be the June quarter, the September quarter? Or is that just impossible to say? I know there's a lot to unpack with cross-currency exposure and things that I don't see in U.S.-based spot. It does seem like your costs are down from their peak. Thank you.

A - Andre Schulten {BIO 22079652 <GO>}

Well, on the second question, I don't know. It's just a very simple answer. On the first question, yes, we see sequential progress on the cost side. But as I mentioned earlier, it's important to understand the two opposing forces. We don't buy commodities. We buy pack material. We buy super absorbers. We buy films, et cetera. And our suppliers are still in the process of passing through their own inflation.

So while their input costs via commodity helps is certainly easing, they also haven't fully caught up to their cost structure hits that they have experienced over the past few quarters. So we'll continue to work with them to find the right solution here. But when exactly that balance is going to occur? Hard to predict.

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

Yes. And just one additional piece of detail on that. It's not that they're slow. It's that we have contracts that cover, as Andre said earlier, cover a period of time. And in many cases, prices are fixed for a period of time. And then it's time to enter into a new contract. And that's what's going to continue to happen for the foreseeable future, not forever.

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But that's why it's difficult, Jason, to look at, and I know you acknowledge this, look at U.S. spot prices as the holistic indicator of the direction of things such as not -- that's not sufficient.

Okay. I want to thank you for joining us today, and thank you for your patience and unpacking all of this. Jon is going to be -- Jon, Andre and the team will be available the rest of the day to continue helping with that. My own on pack [ph], I am very, very proud and thankful for the efforts of our team to grow 5% organically to do it across all categories, to continue to hold share in the U.S. build volume share, to be able to increase our sales guidance all against the backdrop of significant deceleration of the market in China, the situation in Eastern Europe. The highest inflation rates in 40 years. This team has done an incredible job of executing our integrated strategy to continue momentum through all of that.

And similarly, on the bottom line, we talked about the impact on the quarter of commodities, foreign exchange and transportation. If you look at the last fiscal year, plus our forecast for the current year, you're talking about 50% of profit being eliminated as a result of headwinds in those three areas.

We grew earnings per share last year. The team did. We're forecasting to grow earnings per share modestly this year. It speaks to two things, I think, that are very, very important. One is the quality of the team; and two, is the relevance, the continued relevance of the strategy. So for what it's worth, that's my unpack. And if you want to call on and discuss that further, I'm happy to do so. Thanks for your time.

Operator

That concludes today's conference. Thank you for your participation, and you may now disconnect. Have a great day.

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