# Q3 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
- Christopher Carey
- Dara Mohsenian
- Edward Lewis
- Filippo Falorni
- Jason English
- Kevin Grundy
- Lauren Lieberman
- Mark Astrachan
- Nik Modi
- 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 can 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, Chairman of the Board, President and Chief Executive Officer; and John Chevalier, Senior Vice President, Investor Relations.

Execution of our integrated strategies drove strong results in the January to March quarter. Organic sales grew across all 10 categories in -- and in six out of seven regions. Global aggregate market share is holding steady. Productivity savings are accelerating and enabling sustained investment in the superiority of our brands. In-market execution across all five vectors of superiority is strong and consistent: product, package, communication, go-to market, and value. Superior offerings continue to pay benefits for our consumers and retail partners, and in turn, for P&G shareholders. Progress against our plan enables us to increase guidance for organic sales growth and cash return to share owners and to maintain guidance for core EPS growth and free cash flow productivity.

Moving to third quarter numbers; organic sales grew more than 7%. Pricing added 10 points to sales growth, and mix was a modest positive contributor for the quarter. Volume declined 3 points, including a 1-point headwind from portfolio reduction in Russia.

Growth was broad-based across business units with each of our 10 product categories growing organic sales. Feminine Care was up low teens. Personal Health Care, Home Care, and Hair Care each grew double-digits. Grooming, Oral Care, and Fabric Care grew high-single-digits. Baby Care was up mid-singles. And Family Care and Skin and Personal Care grew low-singles. Growth was also broad-based across geographies, with six of seven regions growing organic sales.

Focus markets grew 5% for the quarter. Organic sales in the U.S. were up 6%, including modest unit volume growth. Europe focus markets were up 8%. Greater China organic sales were up 2% versus prior year as the market begins to recover from COVID lockdowns and as consumer confidence improves.

We continue to expect further recovery as consumer mobility increases over the coming quarters. Longer term, we expect China to return to mid-singles underlying market growth rates for our portfolio of categories. Enterprise markets were up 15% with Latin America up nearly 30% and Europe enterprise markets up low-teens. This is the fourth consecutive quarter in which all five sectors grew organic sales double-digits in enterprise markets.

Global aggregate value share was in line with prior year with 30 of our Top 50 category country combinations holding or growing share. Excluding Russia, global value share was up 20 basis points.

In the U.S., all outlet value share was up 40 basis points versus prior year, with 8 of 10 categories holding or growing share in the quarter. U.S. volume share is up 90 basis points versus the prior year, driven by 2 points of absolute volume consumption growth in a market that is still down modestly versus prior year. Strong U.S. share growth in Personal Care has been led by innovation on the native brand in deodorants as well as successful extension into body wash.

Cascade Platinum Plus has driven strong share growth in auto dishwashing, and Dawn share continues to be up more than a point with ongoing leverage from the Powerwash and EZ-Squeeze innovations. Vicks continues to be a growth leader in Personal Health Care and we've delivered strong share growth in the Metamucil and Pepto-Bismol brands.

In Europe, the new four-chamber Ariel Platinum PODS are driving strong consumer demand in Fabric Care. FAIRY Power Spray is growing the dish category and building market share in Home Care. The new Gillette Labs Exfoliating Razor, male and female intimate grooming innovations, and cardboard packaging upgrades are driving strong growth in Grooming.

Moving to the bottom line; core earnings per share were $1.37, up 3% versus prior year. On a currency-neutral basis, core EPS increased 13%. Good progress as we faced $0.31 per share of cost and foreign exchange headwinds in the quarter.

Core operating margin increased 40 basis points as 150 basis points of gross margin expansion were partially offset by SG&A investments and inflation impacts. Currency-neutral core operating margin increased 160 basis points. Productivity improvements were a 290-basis point help to the quarter. Adjusted free cash flow productivity was at 92%.

We returned $3.6 billion of cash to shareowners, approximately $2.2 billion in dividends and $1.4 billion in share repurchase. Last week, we announced a 3% increase in our dividends again reinforcing our commitment to return cash to shareowners. This is the 67th consecutive annual dividend increase and the 133rd consecutive year P&G has paid a dividend.

In summary, against what is still a challenging cost and operating environment, continued good results across top line, bottom line, and cash for the third quarter. 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 in categories, where performance plays a significant role in brand choice.

Ongoing commitment to and investment in irresistible superiority across the five vectors of product; package, brand, communication, retail execution, and value, we are again raising the bar on our superiority standards to reflect the dynamic nature of this strategy.

Productivity improvements in all areas of operations to fund investment in superiority, offset cost and currency challenges, extend margins and deliver strong cash generation, an approach of constructive disruption, a willingness to change, adapt and create new trends and technologies that will shape our industry for the future.

Finally, an organization that is increasingly more empowered, agile, and accountable with a little overlap or redundancy flowing to new demands, seamlessly supporting each other to deliver against our priorities around the world.

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 creation. These are not new or separate strategies. They are necessary elements in continuing to build superiority, reduce costs to enable investment and value creation, and to further strengthen our organization.

Our strategic choices on portfolio, superiority, 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 a commitment to deliver irresistibly superior propositions to consumers and retail partners.

Now, moving to guidance; as we work toward the end of the fiscal year, we are cautiously optimistic. We remain confident in our strategies and the organization's ability to execute them with excellence. We continue to expect more volatility in the macro and consumer environment and expect sustained pressure in costs and foreign exchange as we move forward. On the whole, our consumer markets remain relatively resilient with U.S. and China volume trends improving, but with inflation pressures in Europe weighing more heavily on consumption. We continue to think the strategies we've chosen, the investments we've made, and the focus on executional excellence have positioned us well to manage through this volatility over time.

Raw and packaging material costs, inclusive of commodities and supply inflation, have largely stabilized over the last few months, but still remain a significant headwind versus last fiscal year. Based on current spot prices and latest contracts, we now estimate a $2.2 billion after-tax headwind in fiscal '23.

Foreign exchange is also a significant year-on-year headwind, and rates since last quarter have moved modestly against us. Based on current exchange rates, we now forecast a $1.3 billion after-tax impact to the fiscal year. Freight costs have moderated throughout the year and we now expect them to be roughly in line with prior year. Combined headwinds from these items are now estimated at approximately $3.5 billion after-tax, or $1.40 per share, a 24-percentage point headwind to EPS growth for the year.

In addition to these impacts, we are also facing higher inflation in wages and benefits and higher year-on-year net interest expense. We are offsetting 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 noted in the outset, our strong results over the first three quarters have enabled 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 4% to 5% to approximately 6% for the fiscal year. This would put fiscal '23 in line with 6% top line growth we have averaged over the last four years, which were 5%, 6%, 6% and 7% from fiscal '19 through '22 respectively.

On the bottom line, we are maintaining our outlook of core earnings per share growth in the range of in-line to plus 4% versus prior year. Significant headwinds from input costs and foreign exchange keep our current expectations toward 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 value-creating opportunities are available.

We continue to forecast adjusted free cash flow productivity of 90%. We now expect to pay nearly $9 billion in dividends and to repurchase $7.4 billion to $8 billion in common stock, combine the plan to return $16 billion to $17 billion of cash to share owners this fiscal year.

This outlook is based on current market growth estimates, commodity prices, and foreign exchange rates. Significant additional currency weakness, commodity cost increases, geopolitical disruption, major production stoppages, or store closures are not anticipated within this guidance range.

To conclude, we continue to face highly volatile consumer and macro dynamics. We also continue to see high year-over-year input costs, inflation in the upstream supply chain, and in our own operations, headwinds from foreign exchange, geopolitical issues, and historically high inflation impacting consumer budgets.

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 our business. We are doubling down on the strategy that has been working well and is delivering strong results. We will continue to step forward. We remain fully invested in our business. We remain committed to driving productivity improvements, to fund growth investments, mitigate input cost challenges, and to deliver balanced top and bottom line growth.

With that, we'll be happy to take your questions.

## Questions And Answers

### Operator

(Question And Answer)

(Operator Instructions).

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

## Q - Lauren Lieberman {BIO 4832525 <GO>}

Great, thanks. Good morning, everyone. I wanted to talk a bit about productivity, because over the last, I guess, 2.5-3 years during the pandemic and all the global supply chain challenges, productivity was something that understandably took a backseat, and then this quarter, really seen this significant change in what you've been able to realize. So, I was curious if there is -- if we should be thinking about productivity as something, where there's like a catch-up, where there's sort of projects that have been on the list, things are able to get out, so that productivity could run at an elevated rate going forward.

And it's also interesting, I think, in the context of marketing, how you've been so consistent in investing throughout. There's actually no catch-up on the marketing piece, no need to accelerate reinvestment per se, but maybe some, again, acceleration on the productivity side. So, I'd be curious to hear about that. Thanks.

## A - Andre Schulten {BIO 22079652 <GO>}

Great. Good morning, Lauren.

I think what, as you said, we are catching up right now to return to gross savings levels that are equal or close to equal to those that we've delivered pre-COVID. We have more line capacity available for us to qualify cost savings, more mind space of our teams to be able to identify new opportunities. And as we are able to engage suppliers and get through this inflationary period, hopefully more ideation and new projects to be created as well.

As we've talked on our Investor Day, we see runway on productivity for the next few years driven by Supply Chain 3.0. We have talked about delivering about $1.5 billion of savings with those initiatives between automation and digital capabilities, and we continue to believe that we can generate between $400 million to $500 million a year from media programmatic savings both in terms of scheduling and buying capabilities around the world. Those programs will hold productivity, in my estimation, close to pre-COVID levels, which will allow us to continue to reinvest in media, which will allow us to fund innovation and superiority, and that is really the intent of the model.

So, to answer your question directly, I would not expect a disproportionate catch-up, but I would expect a steady return to pre-COVID levels of net structural savings, both across costs and media.

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

I agree.

## 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, everyone. I actually had just one clarification and then a question and clarification. The $125 million of, I guess, incremental interest expense, can you just give us a little bit more color on that? And again, is that something we need to kind of contemplate in our models as even we look past the fourth quarter? So, I guess, is net interest expense going up?

## A - Andre Schulten {BIO 22079652 <GO>}

Yes, morning, Bryan. Yes. I mean, obviously it is, right. Markets are getting more expensive in terms of credit, and we are not immune to that. So, the $125 million BT we've quoted for this year, I would expect the trend to continue to go up into next year. Now, we are still well-positioned relative to peer group, because we're able to borrow not only in the U.S., but also in Euro and Pounds and in Yen, so that keeps us very competitive. But nevertheless, we're not immune to those increases, so they will continue to go up into next year.

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

And just one piece of perspective there, Bryan. This is Jon.

We've understandably, because it's been a primary driver of cost increases, focused our discussion on commodities. But that's not the only cost increase that we're seeing. We've just talked about interest expense. Andre mentioned in his prepared remarks, wages and benefits, which continue to increase. So, I would just encourage us all to gain confidence from what's happened here, but to realize that there are still, as Andre said, many headwinds that we're working against and we will continue to work against as we move forward through next fiscal year.

## Operator

The next question comes from Dara Mohsenian of Morgan Stanley. Please go ahead.

## Q - Dara Mohsenian {BIO 3017577 <GO>}

Hey, guys. Can you hear me?

## A - Andre Schulten {BIO 22079652 <GO>}

Yes, we can.

## Q - Dara Mohsenian {BIO 3017577 <GO>}

So, on the gross margin side, you were up significantly year-over-year in the quarter for the first time in a couple years. Obviously, some nice sequential progress with the outsized cost savings and the strong pricing, but also your full-year commodity assumptions and freight assumptions are a bit better than they were previously. So, just wanted to get a sense, if we start to see this sustained improving gross margin environment, what's your perspective on the bias to sort of reinvest that upside back into marketing versus let it drop to the bottom line? This quarter, obviously, with the magnitude of gross profit upside, you could do both, but just wanted to get a sense on how you think about that going forward.

And if I can slip in a second part, are you comfortable you're getting a strong ROI on the higher ad spend presumably, obviously, to this quarter? But how do you think about that going forward and sort of ROI on any spend that may be opportune or incremental to what you originally expected?

## A - Andre Schulten {BIO 22079652 <GO>}

Morning, Dara.

We would expect progress on the gross margin side. Actually, we're encouraged by the productivity numbers that have helped us on top of pricing to deliver the first modest increase in gross margin after a very long period of heavy cost headwinds impacting us to the negative side. And as we've done this quarter, we will continue to look for value-creating opportunities to reinvest. We firmly believe the reason why we are able to grow the top line at the range we are growing, the reason why we are able to hold volume share and value share globally in a very tough environment is because of our superiority-driven innovation across product package, communication, and retail execution.

And we believe that as pricing goes into the market and the consumer is even more, I think, sensitive towards the value creation that they are being offered, continued investment across all of those vectors is going to create value and serve us well going forward. So, we will maintain the flexibility to do so, but we will do it in a disciplined and in a very ROI-driven way, as you say.

As to your second part of the question, as ad spending becomes more efficient with our ability to in-house both scheduling and buying of media, more digital capability to be more targeted, that increases the ROI of every dollar we can spend. So, it actually makes investment in media spending more attractive. At the end of the day, we will maintain the concept of balance between top-line growth, bottom-line growth, and cash generation to stick with our ongoing growth model and value-creation model.

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

Just building on Andre's points, which I fully agree with, I want to come back to this notion of balance and our commitment to it. Some of you have heard me talk about this probably many times, but it's worth repeating. So, you understand how we're thinking about things. We have a chart that we use with the leadership team every time we gather, which shows what you would have to believe to deliver top third total shareholder return, which is our objective, entirely through the top line or entirely through the bottom line. And to do it entirely through the top line, you'd have to assume that we can grow 8% from an organic sales standpoint each and every quarter, which is, in our view, unrealistic.

If you try to do it entirely through the bottom line, you'd have to assume that you could expand margins 180 basis points per year. So, five years, 10 margin points in a highly competitive industry, where it's taken us 187 years to build '22 margin points, equally unlikely. So, we are very committed to driving both top line and bottom line. It's the only way we see to get home. I have a trite little saying that we use on occasion, which is, 'top line with no bottom line, a waste of time. Bottom line with no top line, just a matter of time.' We're going to continue to operate in that vein. And if we're successful, you'll see top line growth driven by proper levels of investment and bottom line growth and margin expansion -- modest margin expansion.

One last thing on the point of advertising rate of return or ROI; in addition to what Andre was talking about, we simply have, though it may be hard to believe, a lot of low-hanging fruit that's out there. We have many categories, where we are not at our target levels of reach and that's a very high ROI activity. When we can reduce wasted frequency, reinvest that into expanded reach, very good things happen, as you've seen, by the way, not just this quarter, but for the last four years. And there's no reason to change that approach at this point in time.

## Operator

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

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

Hey. Thanks and good morning. So, overall volume this quarter came in roughly in line, at least with our expectations, but both price and mix delivered upside, which I think implies just better structural elasticity than we were expecting. And I guess the question is, as you balance everything, just your relative confidence is that can continue. On the one hand, you have some tailwinds for sure as China comes back and service levels seem to be improving. Your reinvestment rate is admirable as we've been talking about. But there's obviously uncertainties out there. And so, I guess maybe just a little bit of perspective on your overall confidence and where that confidence is more versus less elevated.

## A - Andre Schulten {BIO 22079652 <GO>}

Morning, Steve. I'll try a careful balance here between giving you perspective on the global basis and not letting you get ahead of yourself in terms of expectations. But the volume decline is better than we would have expected. As you said, our elasticities remain favorable on an aggregate basis. And if you look at global markets, we actually see volume consumption stabilizing. So, you would have seen in previous quarters, global volumes across our categories down roughly 3 to 4 points.

In our most recent read, which is the past one month, volumes are actually down 70 basis points. This is market volume. And if you exclude Russia, probably more around flat, that's with China returning to some level of growth, and it's also with pricing moving into the base. So, we'll see as pricing becomes more annualized, we'll see that stabilization. I don't know if it's going to continue to be neutral. I would expect some level of negativity in terms of overall market volumes, but certainly improving sequentially.

Within that, I think we're taking comfort in the fact that we are able to hold global volume share and global value share despite significant pricing that we are taking, which has enabled, as we said, we believe, by our superiority strategy, a strong vertical portfolio, both tiers and price points, and being present in all channels, where consumers want to shop.

In our biggest, most important market, as we had in our prepared remarks, we were able to grow volume and volume share, 90 basis points over the past three months. So, that's the positive side. On the negative side, Europe continues to be a high-pressure environment. We've been able to grow sales 8% in focus markets, but there was a very strong pricing contribution with negative volumes in the range of 7%. And the European consumer is trading into private label. We see the price differential between private label and branded competitors increasing as private label is delaying price increases.

The consumer continues to be under pressure there, so that's going to be a continued headwind, I think, from the volume side. Overall, I think our outlook is balanced. As we said, we expect market growth to return to 3% to 4% on the value side, and there has to be a positive volume component to that going forward, but it will take a few quarters before we get there.

## Operator

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

## Q - Kevin Grundy {BIO 16423871 <GO>}

Great. Thanks. Good morning, everyone, and congratulations on another strong set of results. I thought maybe we could spend a moment on China and the reopening there, of course, given the importance of that market for you guys being the second largest market behind only the U.S. So, up 2%, sequential improvement, which is encouraging, we see that in the China retail sales, including cosmetics, continues to show sequential progress.

You've been consistent about your target of mid-single-digit growth for that market longer term. However, it also seems plausible that you potentially exceed that level of growth, at least in the intermediate term here, given easier year-over-year comps and then maybe the potential for some inventory rebalancing at retail as consumer demand improves. Can you comment a bit more on what you're seeing in China, and then perhaps offer some broader views on the pace of the recovery, and how you see that playing out? Thank you.

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

Hey, Kevin, this is, Jon. I'll hand it over to Andre to give some more numerical perspective. But I thought it might help just to share briefly the trip that myself and a large contingent of our leadership team were able to make to China in the last three weeks. We spent more than a week there, it was wonderful to reconnect with our organizations, who are doing a tremendous job. We spent time in consumer homes, we spent time with our retail partner leaders in their stores and in their offices. And of course, we spent time with various government authorities.

And without getting into all the details, the bottom line conclusion was a very positive one, and much more than I was expecting even. And I'm kind of a China fan, having worked there many years ago and having lived there. So, my expectations already started high, and those were exceeded.

Having said that, and we talked about this on the last call, this is not going to be a vertical restart. And there will be a number of twists and turns, including some of the ones that you've mentioned along the way. As Andre said in his prepared remarks, we expect China to continue to contribute at a meaningful level over the middle to long term, but everything looks reasonably positive and constructive.

Andre, do you have any other perspective on that?

## A - Andre Schulten {BIO 22079652 <GO>}

No, I think you said it. I think the other component we're not yet seeing is any return of Chinese consumers to travel retail. That is a significant negative for us in the SK-II business specifically. So, that hopefully we see a more positive trend there in the near future, that's the only other upside that I think we have. But as Jon said, I think the recovery at 2% organic sales in the quarter is very consistent with what we would have expected.

## 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 a quick follow-up on or clarification on some of the numbers and then my real question. So, the clarification is, I think you mentioned that mix was a positive impact on sales, but it was a slight negative drag on the gross margins, just like to understand that.

And then my focus question really is, if you could go into more detail on the U.S. business and the U.S. consumer, you mentioned that, you saw an improving U.S. consumer. So, if any kind of clarification around that? And then an update on your pricing in the U.S., how much you saw in the quarter, how much more is there to go in the next quarter? And any kind of impact that you're seeing, any granularity on that would be appreciated. Thank you.

## A - Andre Schulten {BIO 22079652 <GO>}

Morning, Robert.

On the gross margin and sales connection here from mix perspective, the effect that you're seeing here is product mix. So consumers, when they come into our P&G portfolio, tend to trade up into higher value items. We've seen that actually consistently over the past quarters. So that, as they trade up into higher unit sales, that's a positive impact from a mix perspective on the top line. But those higher unit sales items also have higher unit profit, but the growth margin in percentage is slightly lower for some of them. When you think about Adult Incontinence, for example, when you think about Fabric Care, single unit dose versus liquid detergent, gross margin percentage lower, unit sales higher, unit profit higher. So, it's a positive effect both from the top-line and the bottom line standpoint, but the percentage mix is lower.

U.S. consumer, I think, is holding up well. As we said, any indication that we see on our business is that the consumer is still choosing P&G brands. We are growing volume share in a market that is still down on volume. We are growing absolute volume. So, 90 basis points volume share goes, 40 basis points value share goes fairly consistently across periods. We also see private label share stable at 16%, really no movement here over the past one, three, six, nine months, which is a good indication that we don't see any material trade down. Now we're watching this very closely.

And we believe that a lot of that is again driven by our very intentional strategy to drive superiority. We continue to invest in innovation. We continue to invest in product packaging innovation. We're increasing, as Jon said, communication frequency and reach, where we see a good payout and return. We continue to work with our retail partners to ensure that the presentation of our brands in online and in store is as good as it can be.

Last element I would call out is, we are stable in terms of supply and on-shelf availability, which is also helping our overall position in the market. So, stable, I think, is the characterization, but we're watching carefully.

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

And just one additional point, the 6% top-line organic sales growth that the team delivered in the quarter; and as Andre said, sales share, value share growth and value share growth. We still have a couple of categories, where we are not supplying full demand that will be remediated here fairly quickly.

But as you consider the strength of the U.S. consumer, if you look at those key measures and realize that there, while there are both opportunities and risks within the number, there are opportunities as well as risks, which continue to point to a relatively healthy U.S. consumption pattern.

## Operator

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

## Q - Peter Grom {BIO 22424199 <GO>}

Thanks, operator, and good morning, everyone. So, I wanted to ask about the changes in the commodity and freight outlook. Second straight quarter that these headwinds have moved lower, which is nice to see. Can you maybe just give a sense what you're seeing within that bucket? Where are costs moving lower? Where are costs still sticky? And while I don't expect you to comment on '24 at this point, but maybe just conceptually how you see inflation evolving as we look out over the next 12 to 18 months? Thanks.

## A - Andre Schulten {BIO 22079652 <GO>}

Morning, Peter.

Freight is relatively stable at this point in time. As we've mentioned in the prepared remarks, we expect our freight and transportation and warehousing costs to be roughly in line with prior year. And I think that is a reflection of a more balanced capacity situation with the driver to load ratio returning to, I think, more historical norms. Again, given fuel prices and all other dynamics, I wouldn't expect any major change going forward, but we're at least stable.

From a commodity basket standpoint, we continue to see a mixed bag. We have some help in resin-based commodities. We have some help in pulp, though that is moderated by mill shutdowns for maintenance, both planned and unplanned. But on the other side, all our high-energy usage materials, when you think about caustic soda, think about ammonia, all of those are increased in pricing. So, the moderation is really limited and it's not consistent across the basket. So, $100 million after-tax is the only thing we're seeing at this point in time. We also continue to see upstream in the supply chain.

Our suppliers continue to try to recover their input cost increases, their labor inflation. And that continues to be a discussion that is ongoing. I think as we mentioned in CAGNY, some of those contracts roll over 12 months, 18 months. So, these headwinds and these discussions will continue to be with us. Overall, we're expecting as we always do, spot rates will hold on. That's what's based and underlying our planning for next year and our guidance for this year.

## Operator

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

## Q - Andrea Teixeira {BIO 1941397 <GO>}

Thank you. Good morning. So, how should we think about the upside in beauty, and both you, Jon, and Andre spoke briefly about travel, retail being an upside in Asia. How should we thinking also on the other side, lapping the triple pandemic and the respiratory benefit you had in healthcare? It seems you could benefit from digestive recently, but how should we be thinking about the other segments?

And as we just a clarification, as we put in and embedded organic in the fourth quarter is a 4%. But it seems as if you are, as Andre commented, the exit rate on your volume is potentially flat, bearing in mind, of course, the potential risk in Europe. But should we be thinking more of a better quality in terms of the delivery in organic? So, even though it would be a 300 basis points acceleration on a sequential basis, you'd still have better volumes, maybe a flattish to maybe only slightly down, and a 4% price component in there. Thank you so much.

## A - Andre Schulten {BIO 22079652 <GO>}

Hey, Andrea. On the category-specific questions, yes, we see SK-II as a potential beneficiary of travel/retail reopening. Overall, SK-II is recovering well outside of that channel. In China mainland, we saw 8% growth in the quarter. In Japan, we saw 46% growth in the quarter, but the overall results are still held back by travel and retail. So, I think we will see a sequential improvement, but there are many gives and takes in that overall beauty care sector. So, that needs to be seen in context with a lot of other dynamics that are going on around the world.

On the Personal Health Care side, we continue to be very pleased with the results the team is delivering there. And we see sustained growth in the space across respiratory, digestive, nerve care. There are many parts of that portfolio that have very high growth potential. And in some of these areas, as we've talked before, we're still held back by supply constraints, which might provide upside in the future. But again, we have a combination of 10 categories across multiple markets. Some of them will do well in a period of time. Some of them will be held back by negative headwinds. So, we continue to strive for a balanced top and bottom line growth picture. It will be driven by different parts of the portfolio over different times.

From a volume versus price component standpoint, what is important to understand is quarter four, we will start to lap price increases for the first time. So, we had about 8% of pricing in the base, so that will be a negative headwind to the top-line growth in quarter four. And while we see stabilization of volumes, I would expect that there still will be negative volume component to the growth in the near future.

We have still Russia portfolio being with us as a negative headwind. China slowly recovering, but not yet in positive territory from a volume perspective. And as I mentioned earlier, the European consumer is under lot of pressure with private labor pricing, not yet following the branded competition in those markets. So, pricing will come into the base, that will be a headwind to the top-line. I would expect there's still a negative volume component in quarter four.

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

Yes. One thing to remember too is that, we've just taken pricing in both the U.S. and Europe. And I don't think that the data for the current quarter reflects a potential volume impact from some of that pricing. So, I would be looking at volume recovery -- volume to slowly improve over time, but it won't happen overnight.

## Operator

The next question comes from Filippo Falorni of Citi. Please go ahead.

## Q - Filippo Falorni {BIO 21259123 <GO>}

Hey, good morning, everyone. Thanks for the question.

Jon, clearly you've gone through a lot of transformation over the past five, six years at the company, both from a portfolio standpoint, organizational standpoint, superiority. Can you help us understand, how you think internally these changes can help you navigate a potentially weaker consumer environment if what we're seeing in Europe were to expand into the U.S. and some other parts of the world? Thank you.

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

Sure. And Andre may have some thoughts here as well.

The -- what I really like about the strategic choices that we've made and the approach that we're taking currently is that, it is the strongest approach I can think of, for a very healthy economic environment or a very difficult economic environment. The indicated actions don't change. So think, for example, about our embedding productivity as a fundamental part of our D&A. That's something that serves us very well in a positive economic environment as critical in a downward economic environment.

The importance of superiority to consumers in categories, where performance drives brand choice, critical in both a good economic environment and a difficult economic environment. Focus of the portfolio on daily use categories, where performance drives brand choice and superiority within each of those categories across product package, communication, go-to-market, and value for consumers and customers. I don't see anything in that that I would change if we -- I mean, obviously, tactically, there'd be some different decisions on the margin. But the broad underlying approach sets us up very well, even if or particularly if, we end up in a more difficult environment.

## Operator

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

## Q - Olivia Tong {BIO 22252574 <GO>}

Great. Thanks. Good morning. I want to follow up on pricing, particularly on the new pricing, whether, your view in terms of elasticities relative to previous rounds of pricing have -- whether they've changed or stay similar to what you've seen already. And to the extent that you can draw some conclusions on markets, where pricing is now starting to lap versus markets, where you're still rolling out price hikes, can you just compare and contrast what you're seeing, especially since you're starting to see some modest volume growth in the U.S.? Thanks.

## A - Andre Schulten {BIO 22079652 <GO>}

Good morning, Olivia.

The most recent rounds of pricing have gone into effect just in February and March across, and I'm calling out across Europe and U.S., because those are most visible. So, it's hard for us, as Jon said, to determine what the outgoing elasticities are at this point in time. What I can tell you is that, elasticities remain stable, remain favorable, and I think it is also a function of continued investment. It is a function of continued innovation, every price increase or most price increases are connected to innovation, meaningful innovation for the consumer that also guarantees retail support. They are linked to strong value communication. We talked about Ariel Coldwater, Tide Coldwater, Charmin rollback, or lay value communication. And that is meaningful for consumers as they come under pressure.

Many of our categories are categories, where the consumer doesn't want to risk failure. You don't want to wash your clothes twice and you certainly don't want to deal with a diaper failure. So, all of that, I think, is helping us to maintain favorable elasticities across the board. The most important insight for us is, and that's what you see us do in Q3, we need to continue that investment. We need to look for opportunities, where our value is exposed, and I'll call out Europe as an example, because of private label, pricing at a lower pace than the branded competitive set. It is critically important that we maintain that investment level to maintain the value equation.

Where we see pricing lapping or I think where we have the strongest portfolio and the strongest execution in terms of innovation and superiority, we see favorable results, and the U.S. is a good example of that. Excellent in-market execution by the team compared with a truly strong portfolio and strong innovation is delivering both relatively strong results to the balance of market, but also is driving market growth and recovery.

## Operator

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

## Q - Christopher Carey {BIO 21810941 <GO>}

Hi. Good morning. Can you just talk about your playbook in Europe? You've noted European private label is delaying price increases a number of times on this call. We've heard similar commentary from others in Staples. If price gaps to private label remain wide, do you simply accept that new level or do you need to do something about it to be a bit more offensive to close the gap? And I guess, I say that in the context of Europe, of course, but also as a bit of a litmus test for price competition that can play out globally in the months and quarters ahead. And just how you think about managing through that type of dynamic. Thanks so much.

## A - Andre Schulten {BIO 22079652 <GO>}

Yeah, I'll start, Chris, and then I'm sure Jon will add.

I think the team is accepting the reality of an extended or expanded price gap versus private label as the challenge they need to deal with. And as Jon frequently says, we wake up every Monday morning and deal with the reality in front of us; this is a reality we need to deal with.

So, what that means is, we need to create innovation. We need to create product and packaging innovation, communication strategies, and in-market executions that are able to provide value to consumers and retailers. And that's what we're focused on. I don't think that trying to eliminate the price differential is a meaningful and helpful strategy for us. But if we can generate growth via innovation and via superiority that's both helpful for us at the market and the path forward we're choosing.

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

I couldn't agree more. And frankly, while Andre rightly points to a difficult consumer environment. If you look at our results thus far in Europe, they're very encouraging. Not just in the last quarter, but through last fiscal year as well. We're achieving growth rates in Europe that are higher than we've seen in a long time. And so, now is not the time to back off; it's a time to move forward and strengthen the execution just as Andre described.

That doesn't mean we have our heads in the sand. We've made several adjustments to price gaps, not just versus private label, but versus branded competition as we've gone through this period of pricing, and we need to continue to be sensitive to that. But first and foremost, we need to delight consumers and customers with the offerings that we're bringing to market and go from there.

## 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 letting me in and congrats on strong results. A couple of quick questions. So, first on pricing, can you give us some more quantification on perhaps breadth and magnitude? And when you blend it all together, what sort of order of magnitude should you expect at the consolidated level in terms of organic sales contribution going forward?

And then secondly, SG&A, love to see the reinvestment back in the business, but really sharp sequential change, both in terms of year-on-year for overall SG&A and just sequential dollar step up. Can you unpack a bit more kind of, where the money is, where the extra investment is going?

## A - Andre Schulten {BIO 22079652 <GO>}

Yeah, good morning, Jason.

Pricing magnitude, the latest round of pricing is fairly consistent with what you would have seen in the past, but it's very tailored to the market as we said before. Mid-single digits, I think, is the ballpark I would give you for the latest increase. And I think pricing over time will move back to be a contributor to top-line, but not the sole contributor to the top-line. So, we need and the market needs to find a balance here over the next few quarters, to return to modest volume growth and pricing contribution to return these categories to mid-single-digit growth. That's what we're working towards.

On the SG&A line, look, a lot of our reinvestment is driven by innovation timing. So, when are the right initiatives in market to double down on, they are driven by pricing timing. So, when do we and can we support our brands as we take pricing and drive innovation. What I will tell you is the latest push we had as a management team to our earlier discussion was to really double click on our sufficiency in Europe, and to see how high is up, what -- how hard can we push, especially the media and communication side in terms of value communication across Europe. So, that's the one area I will give you, where we paid a lot of attention over the last three-four months.



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

I would just add one thing. It's our category leaders that determine the level of investment that we're making at any point in time. And prior to this quarter, just as you go back in time, there were more situations, where we weren't able to fully supply demand. And obviously those are situations that you continue to invest in mental awareness and -- but not spike that investment, because you can't supply it. And as we get into an increasingly better supply environment, as we did the last quarter, you resume a level of spending now that you can fully support it. So, that's a part of dynamic in addition to the dynamic that Andre described.

## 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. Wanted to ask sort of a related two-part question. More about U.S., but I suppose you could talk globally if relevant. How sticky do you think this strategy of your irresistible superiority is in terms of volumes? Obviously, we see that you're gaining share if you look at the U.S. So, you're effectively trading consumers to higher value products that work better than peer sets, right?

So, it would suggest then there's a stickiness here that perhaps didn't exist in kind of prior cycles. So, be curious how you think about that and how it flows through from a volume standpoint going forward. And related to that on just the volumes, what's your best guess as to why volumes are down from a consumer standpoint? Is a pantry destocking, unloading, does that imply that there are potentially is reloading at a later time if and when consumer sentiment improves? Thanks.

## A - Andre Schulten {BIO 22079652 <GO>}

Hey, Mark. I'll take a first crack.

I think the concept of irresistible superiority is A, dynamic and must be dynamic, and B, is relevant across value tiers. So, as consumers get more careful with their spending, for example, that just means we need to double down on our view of what superiority in some of our lower value tiers means. So, you think about diapers in the U.S. for example, we have Luvs, which is about half the price of a Swaddlers Diaper. And that means that we need innovation on Luvs, because we're now competing with private label and we need to make sure, as consumers look for value that brand can stand on its own from a product packaging, communication and retail execution standpoint to provide value to those consumers.

So, it's really not a strategy that by default drives trade up, it's a strategy that follows the consumer, and is grounded in what the consumer needs and wants over time. So, if we get more stress, that just means we need to double click on the type of innovation and investment we need.

From a consumption standpoint, as pricing goes into the market, we generally see consumers reacting with what you've described. If there are a pantry inventories available, they for a period of time draw down those inventories. And recall coming out of the pandemic, I think, Jon, mentioned this earlier, there were increased pantry inventories available across multiple categories. So, I think that's part of the effect that we've seen. I wouldn't expect any major restocking, because I think we're just returning to more normal levels as supply stabilizes. It's kind of the COVID pandemic goes more into the past. I think consumers return to the normal behaviors.

The other element we're seeing is more careful usage. If you're overall made aware of inflation in everyday media, every day you look twice before you use another paper towel, et cetera. And partially, that's part of our value communication, right, when we talk about Charmin rollback, because the product is more absorbent and has more strength, we explicitly talk about the ability for consumers to use less. So, it's really driven in those elements.

Again, I think the job that we have as market leaders in many of our categories is to drive volume growth back to sustainable levels, and there are many levers. We still have huge household penetration opportunities around the world in many of our categories. We can create new usage occasions, create regimen use across many of our categories. So, those are the things we're focused on.

## Operator

The next question comes from Nik Modi of RBC Capital Markets. Please go ahead.

## Q - Nik Modi {BIO 7351672 <GO>}

Yeah. Thank you. Good morning, everyone. I just wanted to follow up quickly on China. You know, Jon, maybe just given that you were there recently, just on the ground consumer behavioral insights, like what are they going through right now, they're just hesitating, and it's kind of like a choppy. Hey, maybe I'll check out outside and see if I get sick. I mean, just any perspective on kind of how the consumer is actually behaving on the ground.

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

Yeah. You can imagine with what many of them have been through. There's a bit of a whiplash aspect to -- for three years, I was told by that going outside was dangerous and now I'm being encouraged to reemerge. I'm living probably in a relatively small dwelling, many times with multi-generations. And I don't want to negatively impact my family. So, there is a degree of hesitance and questioning. On the same time, there's an overwhelming feeling, at least as I experienced it, of liberation, of hope.

And I was in Beijing, one sunny Saturday afternoon, and the streets were packed. It was absolutely wonderful and joyous. So, I continue to hold on and believe in the mid and long-term opportunities that China presents us with. It's certainly, plus two is a lot better than a negative number that we had in the last couple of quarters. So, there is clear improvement, but I think it'll be a little bit choppy, and all it will take is a little bit of nervousness to stop the reacceleration of the growth. But I would -- my takeaway, Nik, is a positive one, but with near-term caution.

## Operator

Our final question comes from Edward Lewis of Atlantic Equities. Please go ahead.

## Q - Edward Lewis {BIO 5970827 <GO>}

Yes. Thanks very much. I guess, I just covered a lot of ground. But I'd be interested just on the enterprise market performance, just looking in particular at Latin America. I think you said, Andre, it's only 30% growth this quarter, and I think that would be an acceleration around 20% in the first half. Presumably, there's a healthy element of price behind that, but I'd just be interested to hear what's driving this improved performance in that region.

## A - Andre Schulten {BIO 22079652 <GO>}

There is a very healthy element of pricing there, like in every other region, because we're pricing not only for commodities, but we're also pricing for foreign exchange rate exposure in all of these markets. I think the positive effect is the volume is holding much better than in some of our focus markets. The consumer strength is there. I think the overall strength of the brands is better than we've ever seen. In-market execution is better than we've ever seen. Retail partnerships are better than we've ever seen. So, all of that, I think is contributing to a strong price component with a positive volume component, and that drives the 30% results in Latin America.

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

Yeah, just for perspective, in our two largest markets in Latin America, Brazil and Mexico, as Andre is saying, we're seeing volumes high single-digit. So, I don't want you to take away that all of the sales growth as Andre has already said, is pricing. It's a healthy combination, and I also need to give a nod to the team in Latin America, who's just doing a fantastic job.

Listen, I want to close up with just a couple comments and reflections. And the first relates to what we've been through and what I think it portends for the future. And then I'll come in and talk a little bit more about the quarter that we've just completed. But if we had a conversation three or four years ago, and you told me, look, here's what's going to happen; we're going to have this thing called the global pandemic; people are going to die; borders are going to be closed, you aren't going to be able to get to your largest markets, and they aren't going to be able to get to you; you're going to have difficulty getting your colleagues into manufacturing facilities, innovation centers, sales offices, but don't worry, that's not all. We'll have the largest land war in Europe since World War II. The combination of foreign exchange and commodity cost inflation is going to wipe out half your earnings. You're going to see dramatic channel shift in some of your largest markets in terms of where consumers are doing their shopping. And when all that's over, you're going to find that it's difficult to get people to come back to work. How do you think you're going to do?

And my answer to that three or four years ago would be that, wow. Do you think you can grow top-line, bottom line, deliver cash, and return that to shareholders through all that? Without taking you through the details, which you know very well, that's exactly what this team has done. Over the four years that ended last fiscal year, they created $13 billion in incremental sales, $5 billion in incremental profit.

Now, if you bring that forward and look at what happened, what they accomplished in the last quarter, broad-based sales growth, sequential progress in shipment volume, value share, volume share, a return to gross margin expansion, strong productivity savings. At the same time, healthy reinvestment in the top-line, and advancing our level of superiority, our margin of difference in market growth, in household penetration. If those are the kinds of things our investors want to see, they're there in spades in the quarter that we just delivered.

Last point, I promise, but we've talked several times as both Andre and I, about the challenges ahead, and they're real. We will continue trying our level best to do, to serve consumers, customers, each other, society, and clearly share owners. But it's going to be, just as it has been, a bit choppy. And we're taking a long-term approach here, and if there are choices that are right for the long term that cause bottom line difficulty in the near term, we're going to make those choices. And we'll talk more about that as we approach guidance for next year. But if you're thinking across mid and longer periods of time, I think, we've got a great setup here, a great strategy, a great set of capabilities that should enable us to serve all those constituents that I mentioned, very effectively, but we are thinking about that in years, not quarters. Thank you very much.

## A - Andre Schulten {BIO 22079652 <GO>}

Thanks, everyone.

## Operator

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