Company Name: P&G
Company Ticker: PG US
Date: 2019-01-23
Event Description: Q2 2019 Earnings Call

Market Cap: 235,050.34
Current PX: 93.96
YTD Change($): +2.04
YTD Change(%): +2.219

Bloomberg Estimates - EPS
Current Quarter: 1.066
Current Year: 4.410
Bloomberg Estimates - Sales
Current Quarter: 16194.294
Current Year: 66735.905

Q2 2019 Earnings Call

Company Participants

- Jon R. Moeller

Other Participants

- Wendy C. Nicholson
- Jason English
- Ali Dibadj
- Steve Powers
- Dara W. Mohsenian
- Nik Modi
- Olivia Tong
- Lauren R. Lieberman
- Andrea F. Teixeira
- Steven Strycula
- Bonnie L. Herzog
- William B. Chappell
- Joseph Nicholas Altobello
- Robert Ottenstein
- Jonathan Feeney
- Mark Stiefel Astrachan
- Jon Andersen

MANAGEMENT DISCUSSION SECTION

GAAP and Non-GAAP Financial Measures

Additionally, the company has posted on its Investor Relations website, www.pginvestor.com, a full reconciliation of non-GAAP and other financial measures

Jon R. Moeller

Financial Highlights

We're going to keep prepared remarks on the short side today reflecting a fairly straightforward quarter, our recent Investor Day and the CAGNY Conference coming up in just a couple weeks

We'll share result headlines, comment briefly on strategic focus areas, update guidance for the FY and then open the call for your questions

Organic Sales Growth

- So, getting right to it, we've delivered strong organic sales growth in the October-December quarter, putting us ahead of FY targets
- Organic sales grew 4%, driven by volume, pricing and mix. 8 out of 10 global categories grew organic sales: Skin and Personal Care in the teens; Fabric Care and Feminine Care, high singles; Family Care, Oral Care and Personal Health Care, mid-single digits
- Each of our top 15 markets grew organic sales, with China up 15%, India up 16% and Japan up 9%
  - E-commerce organic sales grew nearly 30%

Naturals Entries and Market Shares

- Our naturals entries continued to drive growth including Pampers Pure Protection diapers, Burt's Bees toothpaste and Native deodorants, which we recently expanded into Target stores
- We built aggregate market share. 34 of our top 50 country/category combinations held or grew value share, up from 26 last FY, 23 in FY2017 and 17 in FY2016

Grooming Organic Sales

- Within this strong sequential and absolute progress, we continue to have some challenges
- Grooming organic sales were down low-singles
- Global Baby Care trends improved, but with organic sales only at the level of the prior year
  - In total though, consumption, volume, sales and share are each progressing nicely

Earnings Growth, EPS and Foreign Exchange

- We also delivered strong constant-currency earnings growth
- Core EPS was $1.25, up 5% vs. the prior year
- Within this, foreign exchange was $200mm after-tax earnings headwind, about $0.09 per share
  - So, on a constant-currency basis, core EPS up 13%

Gross & Operating Margins, Cash Flow, FCF and Share Repurchasing

- Gross and operating margins improved sequentially as expected; net strong underlying earnings progress
- Cash flow also remained strong with $4B in operating cash flow and adjusted FCF productivity of 103%. $2.6B of cash was returned to shareowners; $750mm of share repurchase and $1.9B of dividend

Acquisition

- We completed the acquisition of the Merck KGaA OTC assets, significantly enhancing our international presence in Personal Health Care
- We also acquired Walker & Company, with products designed to serve the unique needs of consumers of color

Summary

- In summary, a strong quarter, solid consumption, volume and organic sales growth driving positive market share trends across categories and geographies, strong constant-currency core EPS growth and continued high levels of cash generated and returned to shareowners, all delivered while working to address some category-specific challenges and against a very difficult competitive and macro landscape

Program of Constructive Disruption

- We continue to accelerate change through our program of constructive disruption to meet the remaining challenges we face and to further improve results
- Our strategic focus areas remained constant
- We've made a deliberate choice to invest, as you know, in the superiority of our products and packages, retail execution, marketing and value, not just in the premium tier, but in each price tier where we compete, strengthening the long-term health and competitiveness of our brands
  - We're making solid progress on extending our margin of advantage and increasing the quality of our execution, which show in our results
- As I mentioned earlier, sequential share progress over multiple years

Investment

- Additional investment will be needed to continue this progress
  - The need for this investment, the need to offset macro cost headwinds and the need to drive balanced top and bottom line growth including margin expansion underscores the continued importance of productivity

Cost Savings and Productivity Program

- We are continuing cost savings and efficiency improvements in all facets of our business, approaching the midpoint of our second five-year, $10B productivity program
- We've consistently delivered $1.2B to $1.6B in annual cost of goods sold savings
- We're eliminating substantial waste in the media supply chain, delivering nearly $1B of savings in agency fees and ad production costs over the last four years
  - We see more savings potential in these areas along with more efficiency in media delivery

Organization Costs

- We're continuing to drive savings in organization cost
  - Total enrollment is down nearly 30% since the start of our first productivity program, about 35% when including contractor role elimination

Tax Operating Margins

- P&G is a highly profitable company, before tax operating margins are among the highest in the industry, behind only Reckitt and Colgate, whose margins reflect their concentrations in healthcare
  - We have significant below-the-line advantages, operating with one of the lowest interest expense percentages and one of the lowest tax rates, putting us near the top of the industry in after-tax margin, already highly

profitable and aggressively driving more savings

Cash Productivity and Inventory

- We're also focused on cash productivity, with significant progress in all areas of working capital
- Over the past five years, we have improved receivables by three days, inventory by 10 days and payables by more than 30 days, enabling us to fund capital spending needed to transform our global supply chain

FCF Productivity and Net Earnings

- Over the last seven FYs, we've averaged nearly 100% adjusted FCF productivity and have returned an average of over 110% of reported net earnings to shareowners through dividends and share repurchase

Organization Structure and Culture Changes

- We're making organization structure and culture changes to strengthen our position to win
- We're taking steps to simplify the organization structure, focus effort, clarify responsibility and increase accountability
- We're supplementing the internal talent development with experienced external hiring and we're building category dedication and mastery
- We're strengthening compensation and incentive programs
  - As we discussed in detail at our Investor Day, we're moving to a new organization structure to further dematrix the company and provide even greater clarity on responsibilities and reporting lines to focus and strengthen leadership accountability

Innovation Processes

- We're significantly reducing the level of corporate resources, moving about 60% of corporate roles to the business units and markets
- At the same time, we're leading the constructive disruption of our industry, lean innovation processes to improve speed-to-market, shots on goal and success rates of new products, monetizing internally developed technologies to build value and fund even more innovation investment, disrupting the brand-building ecosystem with digitally enabled one-to-one mass marketing, supply chain transformation enabled by robotic process automation and leveraging digitization and data analytics to drive greater efficiency and effectiveness of all facets of our operation

Operating and Productivity

- We are creating a more engaged, agile and accountable organization, operating at a lower cost focused on winning through superiority, fueled by productivity, working at the speed of the market
  - We're working urgently to sustain our near-term momentum and to position P&G to win over the mid- and long-term

Guidance

Organic Sales Growth, Innovation and Support Plans

- Moving to guidance, having delivered a strong H1 the FY, we're increasing the high end of the organic sales growth range by a point, making the new growth range 2% to 4%
- We have strong innovation and support plans for the back half of the year: Gillette SkinGuard in the U.S. and Europe; upgrades to Tide and Ariel unit dose pods in North America, Europe and Japan; expansion of Crest and Oral-B Gum Detoxify toothpaste to Latin America; continued support of Vicks VapoCOOL, NyQuil, DayQuil, and cough drops through the cold and flu season; Pantene Rose Water sulfate-free shampoo and conditioner; formula and packaging upgrades on Head & Shoulders; new Olay Vitality masks and creams in China; fit upgrade on Pampers Cruisers; and continued strong support behind the range of Always Whisper, Tampax and Always Discreet innovations we've launched recently around the world

Investments and Pricing

- We're innovating and investing to maintain top line momentum but we're also realistic about the market and competitive dynamics that will impact us in the back half of the FY.
- Pricing should remain positive in the back half, but this will increase volume uncertainty and volatility
- We face highly capable competitors with strong plans of their own, macro uncertainties stemming from issues like Brexit, a crisis of consumer confidence in France and trade and other policy impacts that can impact both the top and bottom line

Foreign Exchange, EPS and Costs

- Our efforts and results FY-to-date and the totality of these tailwinds and headwinds leave us comfortable increasing our organic sales guidance, albeit within a relatively wide range
- We now expect all-in sales growth in the range of down 1% to up 1% vs. last year, reflecting 3 to 4 negative points from foreign exchange
- We're maintaining core EPS guidance of 3% to 8%, having delivered about 4% FY-to-date
- The combination of stronger-than-expected organic sales growth and productivity-driven cost savings are offsetting a significantly larger challenge from foreign exchange and commodity costs than we originally anticipated

Earnings and Foreign Exchange

- Our FY earnings outlook includes a potential gain on the sale of land at our Gillette site in Boston
- The land sale, if it occurs this fiscal, will likely contribute about a point of EPS growth for the year
- We're currently forecasting a foreign exchange headwind on earnings of about $900mm after-tax
- Commodity costs are expected to be $400mm headwind and trucking costs will likely be up 25% or more vs. last year's levels
    - Combined, FX, commodities and transportation are nearly $1.4B after-tax headwind, $0.53 per share

Prices and Foreign Exchange Rates

- As commodity prices and foreign exchange rates move, we will take pricing when the degree of cost impact warrants it and competitive realities allow it
  - There will be top line volatility with these pricing moves
- Competition may attempt to take advantage of our moves for short term market share gains
- Overall category consumption may be negatively impacted
  - We'll have to adjust as we go and as we learn

Investments, FCF Productivity and CapEx

- In any scenario, we'll aim to protect superiority building, value accretive investments in the business
- We won't allow short-term pressures to derail the progress we're making towards sustained and profitable top line growth
- Our outlook for items below the operating line is unchanged
- We now expect to exceed our target of 90% adjusted FCF productivity
  - This includes CapEx in the range of 5% to 5.5%

Dividends and Share Repurchasing

- It will be another year of strong cash returned to shareholders
- We expect to pay over $7B in dividends and repurchase up to $5B of shares in FY2019
  - This share repurchase range factors in the cash required to complete the acquisition of Merck's OTC business and other transactions

Market Growth Rates

- Our guidance is based on current market growth rates, commodity prices and foreign exchange rates
- Significant additional currency weakness, commodity cost increases, or additional geopolitical disruptions are not anticipated within this guidance

Summary

To sum up, the external environment presents many challenges

To address these challenges and further strengthen results we continue to accelerate the pace of change

Efforts to extend our margin of competitive superiority, to drive productivity savings to fund investments for growth and enhance our industry leading margins, to simplify our organizational structure and increase accountability, to constructively disrupt our industry, are and will continue driving improved results and will help us achieve our objective of consistently and sustainably growing sales, margin and cash

QUESTION AND ANSWER SECTION

<Q - Wendy C. Nicholson>: Could you talk a little bit more about China? Up 15% I think is a lot stronger than most of us were expecting. Could you comment specifically on SK-II and Olay in China and how they did in the quarter and what your outlook is for the next – for H2. Thanks.

<A - Jon R. Moeller>: It's been a strong H1 and a second quarter in China. If you look at annually, the organic sales progression in China going back three years it's been minus 5, plus 1, plus 7 last year and plus 9 for H1 this year and as you indicated, above that rate in Q2. We do not see a sign at this point of slowdown of the consumer in China as witnessed by those results. Market growth rates continue to be relatively strong.

Within China, just like the balance of the business, we have our successes and our challenges. SK-II and Olay are obviously in the success column with Skin Care, both SK-II and Olay growing strong double digits for several consecutive quarters.

<Q - Jason English>: Two questions for you. First, the change on the $1.3B to $1.4B drag on earnings from cost pressure and currency. I think the $900mm you gave on currency is the same as what you gave last quarter. The $400mm on commodities looks to be the same. So, it sounds like the bulk I think is the – you obviously put a lot of focus on freight. Is freight the incremental driver? And if so, why? Kind of what changed because it seems to contrast with what we've seen of a bit of an abatement of some of that cost pressure? That's question one.

And question two, another source of strength and by the way, congratulations on the broad-based momentum. Laundry's acceleration has been impressive. You had a key competitor earlier this week announce plans for a lot of reinvestment. Can you talk about your own investment plans going forward and how you sustain the momentum in the face of what may be a bit more disruptive competition? Thank you.

<A - Jon R. Moeller>: In terms of your interpretation of the drivers of the $1.3B moving to $1.4B in terms of headwind and that is ongoing premiums in transportation cost. And I think the situation is exacerbated a little bit simply by the strength of the business and the demand that we're placing on that transportation system and just reflective of what we see. We're managing that I think well and putting steps in place, systems in place that should reduce that burden going forward. But for the balance of this FY that's what we're currently seeing.

Our Laundry business is doing as you mentioned extraordinarily well, had a really great quarter and great H1 and it's really the poster child in many ways for the strategy that we're working against, which is performance superiority along with packaging, communication, in-store execution and value, all working for us in that business with things like unit dose detergents which continue to increase household penetration and market share. Our share within that segment, as you know, is very high at 80-ish percent. Items like the fabric enhancer beads growing double-digits. That's a premium priced item. All of that driving category growth which is extraordinarily important for both us and our retail partners and within that ourselves building share as we will do if we are the drivers of category growth. Doing that through increased investment facilitated by productivity improvement, it's just as I said kind of a poster child for the strategy that we're working against.

Henkel and Persil had been a strong competitor. If I just focus on the U.S., Persil remains a 2% to 3% value share. We don't expect competition to stand still. And going back to the strategy, that is what fuels our deliberate choice amongst other things to invest in the five vectors of superiority, always working to improve those and strengthen the long-term health and competitiveness of our brands. We continue to innovate across our Fabric Care lineup. We've got a strong spring bundle that we'll introduce to the U.S. market in the upcoming quarter. That includes Tide pod upgrades with improved film for better dissolution and perfume upgrades as well as two new scents.

Also innovating in the liquids space with heavy duty 10x liquid, introducing products in new benefits spaces, Studio Delicates by Tide and Tide Antibacterial Spray, and there will be upgrades on Gain, both liquids and flings as well. So, our competition is not standing still, nor are we.

<Q - Ali Dibadj>: In the guidance for the year, it certainly seems like you're anticipating at least the risk of a slowdown to top line growth. Are you actually seeing anything yet to support that caution? Are you seeing competitive shifts? We certainly heard from Henkel from a moment ago and before, but are you seeing competitive shifts? Are you seeing any merchandising or inventory shifts at retailers? And importantly, are you seeing any fatigue with trade-up among the consumers at this point in the economic cycle and how sustainable you think that is? And then within that, this 4% organic growth number which you continue to deliver on strongly, is there any way to segregate that a little bit in terms of what is, I don't know, same-store sales, so to speak, vs. new shelf space, new product launches? You mentioned Native in Target, those types of things, just to give us a sense of new vs. old in terms of the growth. Thank you.

<A - Jon R. Moeller>: As relates to the guidance range, I mean, the move here is a positive move, reflecting more confidence in the business, not a negative move. So, we're increasing the top line – the top end of the top line guidance range as you know from 3% to 4%. And we wouldn't be doing that if we had obvious knowable issues that were confronting us today and didn't have the confidence to potentially overcome them.

Having said that, as I mentioned in our prepared remarks, the level of volatility and uncertainty that exists across multiple factors which are out of our control, which impact our business, as you mentioned: competitive behavior, which we expect will be strong in response to our share gains; but even more importantly, the macroeconomic dynamics and the significant uncertainty that's introduced into the equation when we start moving price significantly as we've all seen in previous cycles.

So, it expressed increased confidence, not decreased confidence, but with an open-eyed reality to the volatility of the world that we live in and with the belief that it is too early to declare victory.

<Q - Steve Powers>: Can I focus on Grooming? It's a difficult business to assess the health of from the outside. Clearly, it was a big driver of strength in Q1, yet a drag here in Q2 and I know promotional timing and quarter-to-quarter mix just tends to be more lumpy in that business. But as you think about the full year and the momentum in that business, is H1 run rate indicative of what roughly you expect over the full year? Or do you feel as though H2 can show improved momentum off that H1 run rate given initiatives that that business has underway? I'm just trying to understand how you feel, kind of red light, green light, yellow light, on Grooming generally? Thanks.

<A - Jon R. Moeller>: You asked about – I won't get to all of it, but you asked about fatigue on trade-up. We do not see that. Our premium items are some of the faster-growing items in our portfolio. I described what's happening in Laundry, for example. That growth is really being driven by items that on a per-load basis are premium priced.

If you look at private label as one indicator of trade-up fatigue or perhaps even the reversal of consumer desire, we don't see significant changes quarter-to-quarter. Europe private label shares remained flat, as they have the last three years. It's obviously different by category. I'm talking in aggregate. And the U.S. private label is up 50BPS, primarily in three categories. Our share is also up in the U.S., so there's no indication of a broad scale shift from premium brand superior offerings wholesale to private label.

And in terms of the question on, if you will, the equivalent of same-store sales, I really don't have that data, and it's very hard to tease apart. But what I'll tell you is we do not win from a market growth or share standpoint if we don't do both. Our core needs to be strong. We need to innovate in our core, communicate in our core. That's the largest part of our business.

At the same time, we need to meet the needs, the emerging needs of consumers which are emerging more quickly than they ever have, whether that's new forms, new segments, new needs, and that we've stepped up our activity there significantly. Look at the naturals segment as one example where our pace of activity is as high as anybody's. But still if we [indiscernible] (00:25:58) right focused entirely on naturals and neglected our core, we'd be in a very, very bad place.

So, I think we've got, maybe to the spirit of your question, I think we've got a much better balance today than we've had historically. I feel good about that, but it's the right question to keep focusing on.

Steve, as relates to shaving, first of all, on a global basis from a market share standpoint, we're about flat vs. the prior period. So, there's some element of market that continues to impact this segment. As category leaders, we have a responsibility to address that, which we're working to do. I think you're looking at it the right way in terms of pacing over a little bit longer period of time, call it H1, and I do think H1 in aggregate is representative of what the year should look like.

We have very strong innovation in the back-half of the year with SkinGuard being launched in both North America and Europe. We have some exciting news on the female side of the shop as well. And we continue to make progress from a user standpoint on Gillette shave club. So, H1 run rate I do think is indicative of what we should be attempting to deliver over the year.

<Q - Dara W. Mohsenian>: My question is around the pricing environment. First, pricing accelerated sequentially for two straight quarters at the corporate level. Would you anticipate more progress sequentially in the back half of the year vs. Q2 in terms of y-over-y pricing? And then second in the U.S., I wanted to get an update on how the price increases are going so far, both in terms of retailer receptivity and consumer demand elasticity as well as the competitive response you're seeing in the marketplace.

<A - Jon R. Moeller>: I would expect on a mathematical basis pricing to be slightly stronger driver going forward simply because we'll have a full quarter of those prices in effect in both the second – well, most of them in Q3 and then certainly in Q4. Whereas even in the quarter we just completed, take for example pricing for devaluation in developing markets, there wasn't a full quarter in all markets of that pricing reflected in our results. So, it's not a statement in terms of increasing – price component to top line is not a statement of intent, simply the mathematical expectation.

And then in terms of how that pricing is going, I apologize for this answer but it really is too early to tell. Typically, it takes six, even nine months to understand exactly what's going to happen from a competitive standpoint and we're just getting to the point on some of the initial price increases where we'll be able to understand the full retail response to both our pricing and competitive pricing, both of which have an impact obviously on our result. So, we're going to have to stay tuned on that one.

Having said that, I would offer in broad terms that we have not seen anything definitive that would cause us to have a high level of concern and I make that statement again on an aggregate basis. Across individual products and segments, categories and markets, there are always issues, but in aggregate we're on track.

<Q - Nik Modi>: Just two quick questions. Jon, maybe you can talk about where the organic sales growth kind of over-delivered vs. your going-in expectations, just to kind of get a sense of businesses that are seeing momentum faster than you had expected. And then the second question is I was hoping to get an update on some of the innovations that Procter has created that will be licensed out to other industries. I think you talked about that the plastic recycling innovation at the Analyst Day. So, just curious kind of where you are with that particular initiative. Thanks.

<A - Jon R. Moeller>: Really the outperformance vs. our going-in expectations was broad-based. And you see that when you look at the segment results. Very strong across the businesses with Grooming more or less in line with where we expected, so, with that exception, each outperforming. And that's true generally as well at a market level, particularly when we look at H1 and the results across that H1. So, I think that's very encouraging. The improvement stool here is not one-legged. It's not yet three-legged either, but it's not one legged.

I'm glad you mentioned the monetization effort relative to our innovation that can benefit multiple categories and industries. I'm very excited about that as an opportunity to both create value, really three things, to create value, to create fuel for even more P&G innovation which is incredibly important, and to make an even broader difference in important areas like sustainability across multiple industries and for the benefit of a wide range of constituents. So, when we talk about constructive disruption and changing our approach to doing business and thinking about new ways to create value for all the constituents we serve, that's a program I feel very, very good about. And we'll talk more about – we'll provide some more color to that when we're at CAGNY together in three or four weeks.

<Q - Olivia Tong>: In terms of the organic sales growth outlook, would love some additional color on what gets you from one end of the range to the other because obviously H1 trends were clearly very encouraging, but you kept the low end of the range. So, a couple things, first, where do you think retail inventory stands now? Is there any concern around forward buying ahead of the price increases particularly in emerging markets? And was there anything significant in terms of promo timing and just trying to better understand if you of could break those particular buckets out a little bit? And then, just secondly if you could parse out the price contribution [ph] from developed markets vs. developing (00:33:25). Thank you.

<A - Jon R. Moeller>: I would really look at H1 top line results, Olivia, as [ph] clean (00:33:43), if you will. If we look at consumption levels relative to our shipment and sales levels and triangulate with market share, everything's in line. We don't see any significant – of course, again, at the detailed level there are always some variability but on an aggregate level we don't see any significant inventory distortions or promotion distortions. Again, at the category level there can be some differences there but generally we look at H1 run rate as representative of the business. And we wouldn't have taken up the top end of the guidance range had we felt otherwise.

And then we come back to what I was talking about earlier, which is just significant volatility that exists. I mean, you've seen some of the competitive statements between Henkel yesterday and KC today. Who knows what the trade situation is going to present to us, what it's going to be and what that's going to present to us in terms of not so much tariffs, though that is an impact, but the ability to frankly import and export products freely across markets. That has an impact on our sales.

Another big driver of uncertainty is the pricing that we're taking and the impact that that has on markets. I mean, to give you a sense, if you think about markets like Turkey, Argentina, some of the more pronounced devaluations, we're talking about 30% to 50% to 70% price increases and those are kind of unprecedented and they have a big impact, they can have a big impact on market consumption and depending how competitors respond they can have a big impact on market share. So, we're simply trying to be responsible in the breadth of our guidance range to reflect the range of outcomes that we see as possible.

And as I mentioned earlier, there's a – we're just not at a point – if we had every business growing slightly above the market, I think we'd be much more confident in bringing up the lower end of the range as well. I mentioned in the prepared remarks, we're not there yet in either Baby or Grooming, which are two large businesses. So, again, our change in guidance range is a positive one. It's built on confidence but also informed by open-eyed objectivity in terms of the difficulty of the environment that we face.

In terms of pricing, kind of price mix across developing and developed, as you'd expect, given the devaluation levels of developing market currencies, pricing level is higher there. The combination of price mix is, call it, 5% to 8% kind of range. In developed markets it's more even with price a positive and, mix, a slight negative given for example, the relative performance of Gillette vs. some of the other businesses. So, no different pattern than I think you'd expect to see.

<Q - Lauren R. Lieberman>: I was curious if you could talk a little bit about enterprise markets and the organizational structural changes and you've shared with the Street now a couple weeks back? If you could just give us a little bit of color on sort of practical steps that are underway for changing the operating structure of those businesses.

And also, if going forward you'll be willing to talk about kind of growth rates you're seeing for enterprise markets vs. focused markets? And I guess even just current quarter what growth look like for the U.S., what look like for developed markets in total and then developed non-U.S.?

<A - Jon R. Moeller>: A lot in there, Lauren, which I will try to deal effectively with. As you mentioned, you used the word weeks, which is the appropriate word to use, the time span since we first started talking about the new structure, and we've been working hard since then to bring that to life. As we indicated, we want to go into next FY, July 1, with that structure fully alive. And we spent a fair amount of time defining what role each organization is going to play, and I want to be clear that there's – the design intent here is to drive global categories but approach that growth opportunity in two different ways, one in large and largely developed markets, and another that we think will be more effective in the enterprise markets.

But it's not – the enterprise markets I expect will – [ph] not expect (00:39:25) I know, their strategies will be driven by the global strategies of the categories. Our supply chains will be global, managed by the global categories. Our pricing strategies will be informed by global pricing categories. And really, the enterprise markets' job becomes maximizing the opportunity given those parameters on a daily basis, making decisions real-time in the markets without having to do a lot of internal transaction processing to get decisions made. And we'll be clear about that as we get closer to implementation. But I think it really holds promise. When you operate everything one way, by definition, you play to the least common denominator everywhere, and we want to move off of that and we think this is a much stronger approach.

We are not going to change our segment reporting, but we will continue to give color on what's happening in important markets, whether they're enterprise markets or focused markets, just as we have today. And in terms of the growth rates for the quarter we just completed, if we look at developed markets, classically-defined organic sales growth was 2%. There's some variability within that. I mentioned Japan at 9%; the U.S. was a little less than 2%; developing markets growing in the last quarter at 7%.

<Q - Andrea F. Teixeira>: I wanted to go back to the pricing but layer it with the A&P spend. You had about 200BPS benefit from price/mix on the top line, but about 50BPS gross margin benefit. So, is that a result of the change in accounting for promotions, or were you increasing support to the brands as you introduced the price increase and that gap should narrow going forward to your benefit?

And if I can squeeze in a second question on the China diapers, can you update us on what happened this quarter? So, from the declining volumes in the previous quarter due to pricing, did it normalize, and what should we expect going forward? Thank you.

<A - Jon R. Moeller>: Let me handle the second one first. We had a difficult quarter in China in Q1, as you alluded to, with sales down double-digits. The quarter that we just completed, sales were up double-digits, up about 12%. We performed very well in the two major online events in the quarter which were our 11/11, 12/12, becoming the number one diaper brand on both JD and Alibaba. The premium part of our business there continues to do extremely well, about a 280 index vs. year-ago, that's taped and pants and that's encouraging because that's the fastest growing part of the market.

Our overall share grew the past three months by a little over a point. Again, most of that in the premium segment of the business, up about 3 points overall, up about 5 points online. We do continue to experience significant softness on the mainline taped business, which is down about 25% and we did lose a little bit of value share there but that shift largely reflects market shifts in terms of preference for premium offerings.

You can look – the obvious question as you look at those two quarters is which one represents the future and we're fairly confident about back half growth in China. We've got a very strong program with Chinese New Year and strong innovation plans.

I apologize, on your first question, which is why I went to your second question first. I'm not quite sure what you're asking but I'm happy to talk to you later in the day or you can talk to John and it's my shortcoming for not catching it all. But relative to mix, the fastest growing portion of our business was just indicated in the discussion on Baby Care and also in the discussion we had earlier on Fabric Care has tended over the more recent periods of time to be driven by the premium part of the portfolio. And what I think sometimes gets misunderstood is that doesn't necessarily mean the higher margin part of the portfolio.

So, take Laundry as an example. If you assume just for a second, and we don't assume this, but assume there's a fixed number of loads that are done across the world every year, if we can do – if we can receive more revenue for each one of those loads and generate more profit for our shareowners on each one of those loads, I don't care a whole lot about margin. We're creating value.

And so, what you see in some of those premium offerings is higher per unit per use profit, albeit at a slightly lower margin. And as those items grow faster than the balance of the portfolio, you see that reflected in margin mix for instance, on the gross margin line. I'm not sure that's what you were asking but that's one of the drivers in at least the gross margin mix currently.

<Q - Steven Strycula>: Given your recent success in a lot of the market share gains, particularly in the United States, and private label also gaining share, how are the retailer conversations evolving as planograms are getting reset? Is there a difference in the category assortment conversation, meaning that Procter continues to consolidate as number one and number two and number three brands get displaced? How does this also shape their outlook for the ability to lean in for store brand offerings? Thank you.

<A - Jon R. Moeller>: As you can imagine, an aggregate level answer to that question is not terribly relevant. It's very different across categories and across retail partners. I mentioned first of all just from a premise standpoint, the private label growth, that's occurring largely in three of our ten categories. And even the level of private label market share that exists is very different across the categories, from relatively well-developed to almost non-existent. So, the conversations are different and varied.

Having said that, a couple generalities that I would draw, I can't imagine, well, at least in my experience, which is somewhat limited in this regard, but I can't recall a conversation with a retail partner that wasn't interested in category growing, category driving premium priced items. They're very interested in that. It's the quickest way for them to grow their market basket and their organic sales line and do it in a sustainable, constructive fashion.

I think there continues to be room, just given the diversity of consumers, for both types of offerings in most retail outlets. I don't see this being an either/or type of game. I do think the point that you made about market leaders and drivers of market growth and items on the other end of the portfolio is kind of a bipolar, if you will, growth strategy, is in play at some retail customers. And as a result, I think the least attractive place to be right now is in the middle and that relates both to performance and price.

<Q - Bonnie L. Herzog>: I wanted to circle back with a question on your guidance and while you raised your top line, you did maintain your EPS growth and you called out a few headwinds that will impact your bottom line. But could you talk further about the cost of growth as you see it and then your expectation for this going forward? And then in other words, is it a fair statement that in this environment it's simply costing you more to generate faster growth?

<A - Jon R. Moeller>: I don't necessarily – I understand the nature of the question and have an appreciation for it. I wouldn't say, though, that broadly that's the case. If you look at the quarter we just completed, our growth was among the highest of recent quarters. That's now true for two quarters. And if I look, for example, at our marketing spending as a percentage of sales, because of all the productivity initiatives that I described earlier, that number, while we have a stronger marketing program than we've ever had with higher reach that we're investing in as we reduce excessive frequency, reduce agency and production cost, et cetera, so very strong advertising program, it's not costing us more per, if you will, dollar of revenue gained.

Also, I know there was a lot of concern, and justifiably so, a couple quarters ago across the industry relative to promotion levels and those have generally come down both in our case and in the case of competitors, which you would expect as you're generally in a cycle of price increases. So, the data that I have while I'm sure I could make a use case to support your point, broadly doesn't seem to be representative of the world that we face.

Now, I do think the premium that's placed on excellence of execution has increased. There's no room for anything other than excellence which is why we continue to bang the drum internally and externally on superiority. But I don't – if you do that well, there continues to be strong appeal as witnessed again by the faster growth in some of the premium priced items within the portfolio. So, I don't think in aggregate we're in a place where the cost of growth has to be higher.

<Q - William B. Chappell>: Just coming back to Grooming, we're about to hit the two-year anniversary of the price cuts in the U.S. on the systems. And so I'm trying to understand with where you stand now with seeing still some organic growth declines with kind of market share being relatively flat. As you look back, was that a good idea? Is it something you would have repeated? And does it say something about the category that having to do that kind of cuts two years later still keeps you just status quo that the category really has more challenges beyond price that you're facing?

<A - Jon R. Moeller>: I mean, if you look at H1 growth rates in Grooming, the business is essentially flat vs. year-ago with much better volume share and value share trends than was the case prior to the pricing. So, we've basically stabilized the share position on the business which is important, which leads you to your second question which is the right question. And there is a lot that's impacting the category that's outside of that pricing dynamic and the biggest impact is the societal impacts and the incidence of shaving, both here and in Europe.

The good news is the market decline across manufacturers that's occurred as a result of that is waning, so the drag on a quarter-by-quarter basis is lessening. The good news is, as I mentioned, that our share positions are stabilizing and strengthening. And that's why relative to an earlier question, we talked about a reasonably strong business in the back half of the year.

Big innovation coming as well with SkinGuard, both here and in Europe. So, I called out that business as one that requires more attention and more effort to fully turn. That remains the case. Looking back, in one person's judgment, were we wrong in taking that pricing? Absolutely not. And has it been effective in terms of stabilizing our share position? Yes.

<Q - Joseph Nicholas Altobello>: First, was the weakness that you saw in response to the emerging market pricing this quarter worse than you expected? Or in line?

Secondly, what was U.S. organic growth in the quarter and I think you mentioned U.S. market growth was below 2%. So, what did market share trends look like vs. the 40 basis point gain you saw last quarter? Thanks.

<A - Jon R. Moeller>: That I can give you precise answers across all of your questions on the call, but you can follow up with John and get the specifics. Generally, though, the trends were difficult in the U.S. with the first full quarter of the Harry's expansion, et cetera, and better in other parts of the world. And John can give you a further breakdown on that.

<Q - Robert Ottenstein>: In past quarters you've talked about the disproportionate market share gains that you're getting in e-commerce and I'm wondering – and you talked a little bit I guess about that in China diapers. Wondering if you could give us a little bit more details on how you're doing in e-commerce in the U.S. and China by category and how that's playing out in terms of share. Thank you.

<A - Jon R. Moeller>: Generally doing very well in e-commerce, 30% growth last quarter, now approaching about 8% of our business. We're finding success across E-tail customers and across categories. Obviously there's a degree of variability there but I think the general message and the takeaway is broadly successful.

We don't take that for granted for a nanosecond. It's a very fast growing part of the business that we're constantly adapting our offerings to serve. And that's everything from the way that offering is communicated to a consumer, to the size of the package, to the ability of the package to survive the journey to a consumer's home and our relevance to the individual E-tail partners. But broadly, very successful.

<Q - Jonathan Feeney>: Two questions real quick. First, picking up on a comment you made in the very opening statements, you mentioned that the highest margin competitors you have, I think Reckitt and Colgate you called out, you kind of cited their exposure to healthcare as the reason for their segments, their higher margin. Is that true of your own segments and does that tell us maybe something about maybe the direction? What kind of dynamics are present – maybe are present in your Health Care portfolio or elsewhere that maybe are instructive for your direction?

And second question is oil's down 35% in the quarter, the end of your last fiscal quarter, end of this fiscal quarter that you just reported. Historically, that's been a reasonable indicator of prospective costs. Can you give me a couple of big call-outs for why that might not be the case this time? Thanks.

<A - Jon R. Moeller>: Consumer Health Care margins, to your first question, are generally very attractive. We find that to be an attractive business. It's both a business that has historically grown at very attractive rates and has done so at very high margins, relatively high margins. And that does explain part of our interest in that category and does explain some of the actions we've taken to increase our presence in that category.

And I've been talking for a long time when asked about where we're interested in adding to our portfolio, I've typically mentioned OTC Health Care and Skin and Personal Care as areas that we have both the freedom from a category concentration standpoint and generally the financial attractiveness to at least responsibly explore opportunities to add to our portfolio in those categories. And I would not expect that to – that should continue.

In terms of your question on oil price, two points to make there. One is, and I know this wasn't your question, but just for clarity, given the opportunity, about 1% of our commodity exposure is kind of directly oil. About 5% of our commodity exposure is highly correlated to oil in relatively short periods of time. There's another big chunk of our commodity exposure that is the petro complex, but that is not highly correlated in short periods of time to the price movements of oil. It's more driven by demand and supply dynamics within those individual supply chains.

Typically, the bleed-through effects, if you will, take six to nine months, which is why in this update you don't see us making big changes because within the forecast period we're talking about, which is the next five months, we're not expecting big changes. But clearly, to the extent that those prices stay low, we would expect some bleed-through to our commodity costs over time. Obviously, things like pulp are unaffected by that, as are some of the other materials. I know this wasn't part of your question either, but for completeness, lower oil, though, is not necessarily a net positive from a holistic EPS standpoint. It will have some impact on commodity costs, as we just discussed, but it also has impacts on consumer confidence and on personal budgets in producing countries and it can have a significant impact on the ability to purchase products in our categories in those countries.

So, you need to be careful as you look at oil both relative to its direct cause and effect on our commodity structure, but also the impacts it has on the demand environment.

<Q - Mark Stiefel Astrachan>: I wanted to ask, just first broadly, any change in how you think about category growth on a global basis? And then depending on I guess the answer to that, are you seeing any increasing distance between your growth or maybe even broadly kind of the haves and have nots across various categories and geographies?

And in particular, if you go back a couple of years ago, local and regional competitors I think have generally done a better job than they did maybe 10 years ago. Is that gap narrowing between the multinationals and local and regional? If not, is it some of the bigger multinationals that are kind of stepping up their game and pressuring some of the others? And I say that more on a developing market basis, just given that you've had much stronger growth in that business than in developed markets. But feel free to answer kind of how you see it across whatever geographies make sense.

<A - Jon R. Moeller>: Category growth is improving slightly which is very encouraging, and we see that fairly broadly. We see that in the U.S. We see that in developing markets. So, that has been a positive dynamic and is a recent dynamic. Don't get me wrong, we're not talking about categories moving from 2.5% growth to 5% growth. We're talking about categories moving from 2.5% to 3% growth on a global basis. But all good, all good.

In terms of the near-term competitive environment, the local and regional brands are continuing to perform extremely well, from both a growth rate – primarily from a growth rate standpoint but also if we look at who's gaining share, in many cases they are the share gainers. Where we've lost business and lost share it has typically been and obviously this is a highly general aggregate statement, but has more frequently been to those local and regional competitors than to our global multinational competitors, though there are clear exceptions to that.

So, the gap continues to narrow. That explains a couple of things in terms of our own strategy. One, again, is to redouble our efforts on meaningful obvious superiority and that's not just vs. branded manufacturers, that's vs. private label manufacturers, that's not just against global competitors, that's against local competitors and that is extremely important that we maintain a positive position there.

The other is we've made a real effort to distribute resources more in market as opposed to at regional or global headquarters. China's a very good example where we've been very intentional in doing exactly that for exactly the reasons you cite, being as close to those consumers as we possibly can, being as close to the evolving competitive environment as we possibly can and it's made a real difference.

So, again, we as you know in the quarter we just completed are in a share growth position but we don't take any of that for granted and are considering the entire competitive set as we calibrate the sufficiency of our efforts.

<Q - Jon Andersen>: Can you give us kind of a broad based update on the global supply chain work that you're doing? And the reason I'm asking is I'm wondering whether you're considering this work more kind of table stakes in terms of serving retailers and channels and end consumer or whether you're working toward an infrastructure you think that can be truly differentiated and kind of a source of competitive advantage, maybe through better unit costs, speed to market, service levels, et cetera. Thanks.

<A - Jon R. Moeller>: I would say the intent is both. Retailers are demanding more in terms of service levels on the part of manufacturers and we need to restructure and retool ourselves to be superior in delivering against their needs. I do believe that in addition to that, to those table stakes moves as you described and that we need to make that they're a real source of competitive advantage that we're creating through our supply chain transformation. A simple aggregation of multiple categories within a site has a huge impact on unit costs, 50% of the cost of manufacturing facilities, the infrastructure of that facility, the roads, the rail spurs, the utilities, et cetera. Even more importantly, the service we can provide as a multi-category supplier with full trucks in quantities for each category that work for our individual retail partners, at very effective costs, because we can combine both products that cube out of truck and products that weight out of truck and can deliver those products on a daily basis to our retail partners is a real competitive advantage.

I think the ability to, if you will, white paper our processes and manufacturing platforms. I talked about robotics and the digitization that's occurring in our factories. We will make step function improvements, exponential improvements vs. where we were and I think where most of our competitors, not all, but where many of our competitors are. So, thanks for raising the question. I think it will serve both. We're still midstream in our efforts here so there's more work to do and there are more savings to come.

Jon R. Moeller

Closing Remarks

Again, we're very excited about H1 our FY and the progress we've made but are not declaring victory, have more work to do to further improve results and are committed to do that

Please take the increase in the top line guidance as indicative of confidence, not fear, but wanting to be very realistic with you about the environment that we see and we operate in and hopefully we'll continue to make progress