Q3 2018 Earnings Call

Company Participants

- David S. Taylor, Chairman, President & Chief Executive Officer
- Jon R. Moeller, Vice Chairman & Chief Financial Officer

Other Participants

- Ali Dibadj, Analyst
- Bonnie L. Herzog, Analyst
- Dara W. Mohsenian, Analyst
- Grant O'Brien, Analyst
- Jason English, Analyst
- Jonathan Feeney, Analyst
- Joseph Nicholas Altobello, Analyst
- Kevin Grundy, Analyst
- Lauren R. Lieberman, Analyst
- Nik Modi, Analyst
- Olivia Tong, Analyst
- Steve Powers, Analyst
- Wendy C. Nicholson, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

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

Also, 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 the underlying growth trends of the business and has posted on its Investor Relations website, www.pginvestor.com, a full reconciliation of non-GAAP and other financial measures.

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

Jon R. Moeller {BIO 16200095 <GO>}

Good morning. I'm pleased to be joined this morning by David Taylor, P&G's Chairman of the Board, President and Chief Executive Officer; and John Chevalier, Vice President, Investor Relations.

I'm going to start this morning with a brief review of the company's results for the January, March quarter and our outlook for the fiscal year. David will provide additional perspective on the year, an update on key strategic focus areas and perspective on the announcements we made this morning regarding the planned acquisition of Merck KGaA's OTC Health Care portfolio and the dissolution of our over-the-counter health care joint venture with Teva. We'll then open up the call for questions.

This was a challenging quarter in a very tough environment. We grew through the challenges delivering modest top and bottom line growth. We continue to improve in productivity while investing in our brands. As a result, we remain on track to deliver our fiscal year objectives, but we must and will do better than this. The ecosystems in which we operate around the world are being disrupted and transformed. We must change at an even faster rate, winning through superiority, stronger cost and cash productivity and the strength in the organization and culture.

Good news, we increased the dividend by 4%, the 62nd consecutive year the P&G dividend has been increased. We also announced this morning significant moves that will strengthen our hand in OTC health care, positively contributing to the company's growth and profitability.

Overall, volume of value share trends continue to improve. Volume shares now in line with prior year levels, improving in both developed and developing markets. 7 of 10 global categories are now growing or holding volume share.

Value share is down 30 basis points all in and adjusting for inter-category mix impacts is down just 10 basis points. Several large businesses are moving to positive share trends. Feminine Care and Skin and Personal Care shares are growing. Global Shave Care value share is now in line with prior year on both a three and a six-month basis. Fabric Care, Home Care and Personal Health Care are all growing share.

Sales growth has been challenging in a very difficult market environment. We have several – we have large businesses in several difficult markets, Saudi Arabia, Egypt, Nigeria, Brazil, collectively more than a 30-basis point top line headwind.

Retail trade transformation in the U.S. is reshaping our categories, rapid shifts to e-commerce and aggressive inventory management. Trade inventory reductions, primarily in the U.S., drove organic sales down by roughly a point this quarter.

From a business standpoint, we're not where we need to be on two large businesses, Baby Care and Grooming. David will discuss both. The balance of the company portfolio is growing organic sales over 3% fiscal year-to-date. We have opportunities to continue to improve noticeable product, packaging, communication, go-to-market and value superiority of our offerings across the portfolio, and to fuel this would even increase levels of productivity, each of which we're committed to do.

All-in sales were up 4%, including about a 3-point benefit from the net of foreign exchange acquisitions and divestitures. Organic sales grew 1%. Organic sales growth was again volume driven with volume up 2%. We delivered solid organic sales growth in Fabric Care, Home Care, Feminine Care, Personal Health Care and Skin and Personal Care.

Looking geographically, we delivered mid-single digit growth in Greater China, Japan, France and the Philippines; high single-digit growth in Russia; double-digit organic sales growth in India and Turkey. E-commerce sales continue to be very strong, up more than 30% fiscal year-to-date. We're holding or growing e-commerce market share in 8 of our 10 product categories. This growth was partially offset by results in Baby Care and Grooming, both of which were down this quarter versus the prior year.

Mix mainly from strong growth of premium-priced products added a point to organic sales growth. Pricing rounded to a 2-point headwind on organic sales. On its face, the rounded number may appear like a substantial increase in pricing investment. Unrounded, it's about 1.5 points, about 30 basis points different than last quarter with some factors driving the pricing now starting to annualize.

U.S. Gillette pricing interventions reduced organic sales by about 30 basis points. We annualized the price change at the start of this month, and we expect stronger sales going forward. The U.S. Oral Care business recently rescinded a list price increase they had taken last year in the U.S., which left us operating in an unsustainable price premium. This dynamic is causing a short term negative price impact as well that will start to annualize in July. Fabric and Home Care pricing is lower due to promotional investments to maintain competitiveness in the U.S. and Europe. These, too, will annualize later this calendar year.

Looking forward, we'll continue to ensure our brands, inclusive of product performance, remain an excellent competitive value for consumers. This will include price increases and mix improvement as we bring new meaningful benefits to market. We'll also price to offset rising commodity costs when the degree of the cost impact warrants it and competitive realities allow it. With this, plus the annualization of key investments, we currently expect to return to positive price trends sometime next fiscal year.

On the bottom line, all-in earnings per share were $0.95, up 2% versus the prior year. This includes $0.04 per share of non-core restructuring costs and $0.01 of non-core charges related to the Tax Act. Core earnings per share were $1, up 4%.

Core operating margin declined 100 basis points. Core gross margin declined 110 basis points due mainly to higher commodity and freight costs. Core SG&A costs decreased 10 basis points as a percentage of sales. Productivity savings and cost of goods and SG&A were a 310-basis point benefit for the quarter.

The core effective tax rate was 21%, two points below the year-ago level, due mainly to the impact of the U.S. Tax Act. This benefit was partially offset by increased interest expense and currency swap costs as we optimize international cash management under the new U.S. tax laws. The rate was somewhat lower than we anticipated last quarter as we continue to gain a deeper understanding of the provisions enacted as part of the Tax Act.

Adjusted free cash flow productivity was a strong 95%. We continue to make good improvements in working capital as we leverage our supply chain financial initiative.

We repurchased $1.4 billion of shares and distributed $1.8 billion in dividends. In total, $3.2 billion of value returned to shareowners this quarter. As I mentioned earlier, we increased the dividend by 4%, the 62nd consecutive annual increase and the 128th consecutive year P&G has paid a dividend.

Moving to guidance for fiscal 2018. We're maintaining our guidance range for organic sales growth of 2% to 3%. We're at 1.4% fiscal year to date, leaving us at the low end of this range potentially rounding up to 2% for the full year. We expect fiscal 2018 all-in sales growth of about 3%. This includes a net benefit from the combination of foreign exchange acquisitions and divestitures.

We're raising our outlook for core earnings per share growth from a range of 5% to 8% to a range of 6% to 8%. Commodities are projected to be a $350-million after-tax headwind for the year, consistent with the outlook we provided last quarter.

Transportation costs are now a $200-million headwind for the year. Foreign exchange is roughly $175-million after-tax benefit. The combined impact of commodities, transportation and foreign exchange are $0.14 per share impact on core earnings per share, a four-point drag on core earnings per share growth.

Despite these headwinds, we expect to return to gross margin and operating margin improvement in the fourth quarter driven by strong productivity progress while maintaining investments in our brands. We now expect the core effective tax rate for the year to be in the range of 22% to 22.5%, about a half point lower than our previous outlook.

As we discussed last quarter, the changes included in the U.S. Tax Act are broad and complex. The charges we booked for the non-core impacts and the core effective rate may ultimately differ from our current estimates and require further true-up. There's still potential for changes in regulatory interpretation of Tax Act provisions. There may be legislative actions that arise because of the act. And our estimates of the impacts may change as we refine our calculation for earnings and exchange rates for our foreign subsidiaries.

We're also increasing our guidance for adjusted free cash flow productivity from 90% to approximately 95%, reflecting strong year to date results and our outlook for the fourth quarter. This guidance includes capital spending in the range of 5% to 5.5% of sales.

Fiscal 2018 will be another year of significant cash return to shareholders. We expect to pay nearly $7.5 billion in dividends and repurchase shares in the range of $6 billion to $8 billion this year. Combined, returning between $13.5 billion to $15.5 billion of value to shareowners, following $22 billion last fiscal year and $16 billion in fiscal 2016.

In summary, we're growing the top and bottom line in a difficult environment with improving market share trends. We're driving cost and cash productivity, returning cash to shareowners, investing for the long-term health and competitiveness of our brands and strengthening our OTC health care unit.

I will now turn it over to David to talk more about our strategic priorities, the Baby and Grooming businesses and the acquisitions we announced this morning.

David S. Taylor {BIO 15435092 <GO>}

Thanks, Jon. Before I talk about the longer term strategic choices we've made, I want to be very clear about something. This is not business-as-usual P&G. We will make additional changes needed to accelerate progress. The strategy needed to deliver balanced top and bottom line growth requires accelerated progress against the five elements of superiority, product, packaging, brand communication, retail execution and value, both consumer and customer, as well as stronger progress in productivity to fund these changes.

We also recognize and are taking additional actions to make the needed organizational changes to enable greater speed, local agility, and accountability. While our plan is clearly showing evidence of progress in many areas, we have not yet tied it all together to deliver the industry-leading balanced growth and value creation we expect of ourselves.

Before I go further, I want to underscore a point that Jon just made about how we're managing this fiscal year. We've made a deliberate choice to keep investing in product and package improvements, sales resources, marketing and consumer value despite profit pressure from commodity cost and sluggish sales growth, to continue to strengthen the long-term health and competitiveness of our brands.

Now one example of the additional interventions made include the additional $200 million to $300 million of savings to mitigate a portion of the investments needed and deliver our fiscal year objectives, but more is needed to fuel the top line and deliver share growth in what has been a more challenging environment.

What we won't do is sacrifice the long-term health of the business by cutting important investments. As you know, our portfolio is daily use categories where products solve problems that consumers care about and performance drives brand choice. We understand what it takes to win in all 10 of our core categories.

In brand-country combinations where we judge our sales to be noticeably superior in at least four of the five elements that we've talked, we're seeing consistent meaningful improvement in the financial measures of success, household penetration, which is bringing in new users, market growth, value share growth, sales growth and profit.

However, there's still too many brand-country combinations where we aren't superior in at least four of the elements. And in these parts of the business, we're not growing at the rate we need to. I'm going to give some very clear examples where we've not delivered yet and we're taking additional steps to address these.

First, Baby Care. Baby Care is our largest improvement opportunity. The challenges we face are market specific and are very well understood. We're addressing them quickly, and they've taken longer than planned to resolve. But recent trends in China on our global Pants and Naturals launch illustrate that we can make progress in important growing segments. Now we need to get the total brand growing across key markets. That is the next step.

I'll give you a little more detail in China Baby because I know it is a high interest area. Overall, Diaper organic sales in China were up 2% this quarter. This is an important turning point, not the endpoint, but the first quarter of growth in 16 quarters. We're getting our portfolio adjusted and we're getting the capacity in plants in place to win. This compares to a 12% decline in the first half of the year. Clearly, we're making progress, and what's driving the progress and improvement is pants style diapers and premium taped diapers. We're starting to win in the fastest-growing segments.

But there are also (15:15) the declines in mid-tier taped diapers. While our mid-tier taped diapers account for about half of our Diaper sales and the segment itself is declining at double-digit rate, we need to make and are making the needed interventions to stabilize that segment. But clearly, success needs to be winning big on the growing forms while stabilizing mainline. It's not that the plan isn't working, but clearly it's taking more time to stabilize the mainline business than planned.

Let me move to the U.S. Here, we face a very different set of challenges. The market is changing and some customers are aggressively pursuing private label with aggressive pricing. The lower private label pricing has been a real challenge, particularly for our Luvs brand. While we've taken some steps to restore Luvs' competitiveness, it hasn't had the desired effect yet. For perspective, prices are down almost 20% in some areas. We are taking more action, including marketing, in-store presence, and where needed, value adjustments.

Now looking around the world, Pampers is a large brand in many difficult markets that Jon mentioned earlier, in the Middle East, Africa, and Brazil. We're going to start to annualize some of these market specific dynamics over the next few quarters. We also had a tough period in Europe, which has started to reverse.

A clear bright spot for Baby Care is the continued progress of Pampers Pants. This segment makes up 25% of the global Diaper category and is growing at a mid-teen rate. Pants style diapers now account for 27% of all diaper changes, up 3.5 points in the last year. Majority of global diaper market growth over the next five years will be driven by pants style products. So it's absolutely critical that we win here.

Pampers Pants has held the number one global value share position for more than a year, currently at about 28% of the form and has extended its lead against a highly capable set of competitors.

Now another business that's been difficult to grow at our target rates is our Grooming business. We made a very set of tough choices to improve our position in Grooming in the U.S. a year ago, and we're seeing some positive progress. The U.S. Male Shave Care business grew volume for the fourth straight quarter with male shaving systems up 10% this quarter. We expect the strong shipment volume growth we delivered over the last year to translate into stronger sales growth now that the price changes annualize in this quarter. This is starting to play out as we're growing volume share and value share in the past one and three-month basis in the U.S.

Ultimately, our objective is to grow the number of users of Gillette blades and razors. Volume trends (18:08) are encouraging. This is a big improvement following years of declines of as many as 2 million users. And we're now facing a new challenge on Gillette in the U.S. where value-tier competitors expanding in-store distribution this quarter, and some of the competitors are expanding their direct-to-consumer propositions to new markets in Europe.

We see these. They are not surprises, and we have strong plans in place to support Gillette. When we get the superiority model in place, we stimulate market growth and market share growth. I shared quite a few of these examples when we talked at the CAGNY Conference in February.

Our Fabric Care business in the U.S., Japan and several markets in Europe, our Always Discreet incontinence product, SK-II, Olay in China, and (18:59) Dawn hand dishwashing liquids. I'll also share that we need to respond to a changing world and the changing consumer set of needs. One obvious area is increased demand for natural and sustainable products.

First, a couple of comments on the sustainability consumers. Here, we've had a number of innovations. They include products like Tide, Gain and Ariel unit-dosed detergents, the most compacted detergents available.

On the Naturals side, we're getting in the game and getting new with conviction with brands like Tide purclean, Gain Botanicals and Dreft purtouch. They're bio-based offerings that deliver outstanding cleaning performance the consumers want in addition to the naturals profile.

In Fem Care, we've launched Whisper Pure Cotton in China with 100% natural cotton top sheet. Pure Cotton is off to a very strong start with sales more than double our ingoing expectations.

In Baby Care, we're expanding distribution of Pampers Pure Protection diapers made with no fragrance, parabens, or chlorine bleach. And Pampers Aqua Pure wipes made with

99% water and premium cotton. And so far the retailer support has been very good and early consumer reviews are encouraging.

For perspective, already our share in-store is passing several category incumbents in this space that have been in the market much longer. Consumers want performance and more natural ingredients and less of an environmental footprint. P&G brands can deliver that to them.

One other example is our recently launched ZzzQuil PURE Zzzs. This is a melatonin-based sleep aid free of artificial flavors, gluten, lactose and gelatin, also with good distribution results.

Now these organic innovations strengthen our brand equities and attract new users to brands they already know. But now offer the combination of performance and added natural and sustainability benefits they want. In many cases, a strong brand can carry this segment.

In other cases, we'll need additional brands. We've augmented these organic innovations with recent acquisitions in the natural space. Native, a natural deodorant, and Snowberry Skin Care, a naturals brand based in New Zealand. We'll remain open to whatever it takes to make sure that we win in this fast-growing segment.

Next, I'd like to comment a little bit on the strengthening of the Personal Health Care portfolio, a category we have previously identified as very attractive to us. Today, we're announcing, to be (21:35) a meaningful step forward. I'm sure you've all read, we've agreed with Teva to terminate our PGT partnership effective July 1. We operated a very successful JV with Teva for nearly seven years. We grew organic sales at a compound average rate of almost 8%. However, we and Teva have concluded that our strategies and priorities going forward are no longer aligned. The partnership accomplished everything we intended, and I want to thank Teva's management, employees who worked side-by-side with us to make it such a success.

We are moving post-Teva to strengthen our OTC capabilities and growth opportunities with the acquisition of Merck's Consumer Healthcare Business. Merck's talent and portfolio is a near perfect replacement for the capability and scale lost by dissolving the PGT JV, bringing significant technical and commercial capability in-house that will complement the capabilities that already reside in P&G's global consumer healthcare business.

This deal adds a portfolio of about $1 billion in annual sales, primarily in Europe, Latin America and Asia. It has been growing mid- to high-single digits. Another benefit of this acquisition is that Merck's OTC brands bring benefit to new therapeutic areas. They cover a range of treatment areas including relieving muscle, joint and back pain, colds and headaches, as well as supporting physical activity and mobility. Many of these treatment areas are not currently addressed in our current P&G portfolio.

Currently, P&G's OTC business generates over $2 billion in annual sales and has been a growth and value-creation leader for P&G, delivering profitable mid-single digit growth. Our portfolio includes the single largest consumer healthcare brand in the world, Vicks, with over $1 billion in annual sales. With Vicks, we are a leader in OTC cold treatments and in digestive health with the Metamucil, Pepto-Bismol and Align brands. We see several areas where Merck's capabilities can accelerate P&G's brands and businesses.

Now we believe Personal Health Care will continue to be a financially attractive category. It's a huge category at about $230 billion in sales and with strong profit margins. The three megatrends that have supported growth of OTC healthcare for the last decade and they should continue for many years to come. First, the aging population. Today, there are about 650 million people aged 65 or over. This is projected to more than double to about 1.6 billion people by 2050. Over the same time period, the global average life span is projected to increase by almost eight years.

Second, as people age, they are focusing more on wellness. Instead of associating old with a number, people are associating age with how they feel and the quality of their life.

And the third big one is consumers are taking more control of their health and wellness, proactively seeking information on products and services that improve their quality of life. In addition, both public and private sectors are trying to mitigate rising healthcare costs.

Given this demographic and societal context, consumers in developed markets already spend a substantial amount of discretionary income on health and wellness. And as incomes grow in emerging markets, they are also spending more to manage their family's health. As a result, we continue to believe that companies with the best consumer insights with meaningful consumer-driven innovations delivered on trusted brands will be best positioned to capitalize on these trends, leveraging leading capabilities technologies and brand assets to solve problems for consumers to improve their lives, completely consistent with the strategy for the whole of P&G.

Now, I was hoping you can see, OTC healthcare is a very attractive market, and we're excited to add Merck's brands and talent to P&G.

Now I'll turn it over to Jon to give you some more details on the financial implications for P&G of these transactions, including the dissolution of the PGT joint venture with Teva.

Jon R. Moeller {BIO 16200095 <GO>}

The Procter & Gamble-Teva joint venture will continue to operate through June, the end of our fiscal year, and the Merck deal will close outside of this fiscal year, so there's no impact from either transaction on fiscal 2018 forecast or results.

Completion of the Merck consumer healthcare transaction is, of course, subject to customary anti-trust reviews and approvals. While we don't anticipate issues, it's difficult to predict precisely when that transaction will close. If we assume the Merck transaction closes at the end of the calendar year, we expect the deal will add about $500 million to

P&G all-in sales and will be neutral to organic sales core earnings per share and all-in earnings per share growth in fiscal 2019. It will be accretive after that growing at a faster rate in the balance of the company at very attractive margins. We don't expect significant impacts to capital allocations choices and obviously had full line of sight for the deal as we made the decision to increase the dividend by more than we did in the prior year.

David S. Taylor {BIO 15435092 <GO>}

Thanks, Jon. We're excited about the potential this combination creates to continue strong profitable growth of our Personal Health Care business. In the balance of the portfolio, we're expanding to the new relevant benefit areas amidst the several organic expansions in the natural space. We're solving more problems for consumers; Always Discreet in female incontinence; Scent Beads in Fabric Enhancers, and we're innovating quicker and more cost effectively using lean innovation techniques.

We're making progress but we face highly capable competitors who continue to innovate their products and business models. Addressing these challenges and extending our product package and demand-creation superiority will require investment which underscores the importance of productivity. We will continue to drive productivity improvement to lower cost and generate cash. This must accelerate even from today's pace.

We completed a $10 billion productivity program in fiscal 2016. We're in the second year of a 5-year program targeting to deliver up to another $10 billion in savings. I'll give you another example of where it's not business as usual for P&G and we're going to accelerate our pace of change. Includes our supply chain transformation in the work we're going to do to reinvent the media supply chain. We've talked with you before about the progress we're making to transform our supply chain. We started production of the first of several categories at our new state-of-the-art multi-category manufacturing facility in West Virginia. You probably heard about the changes we're making in the media supply chain and our work with agencies. We're taking big steps to reinvent the media supply chain and help our brands work with agencies. And we're pioneering new approaches to dramatically improve our brand building.

Agency reinvention is attempting to raise the bar in superior brand communication. With greater productivity on non-working marketing spending, we create the means to reinvest in media and sampling to drive growth. And we started with upgrading the consolidated agencies from 6,000 to 2,500, saving $750 million through 2017. The next phase, which goes to 2021, consolidates further the 1,250 agencies and saves another $400 million through reinventing agency models and I'll mention just a few of the biggest changes. They include a fixed-and-flow model where we structure a fixed retainer with a core agency for work like large campaigns, supplemented with open-sourcing agencies on an in-and-out basis for flow to the work (29:43) model. A people-first approach where we identify the start creative (29:48) talent we want in our businesses from across agencies and bring them together for better creativity, importantly at the speed of the market. And in-sourcing work like media planning that can be done at greater value inside P&G.

New media, new support models, some with, some without a TV-led communication plan, are key principles to connect our brands to consumers and have people empowered, agile and accountable, with more resources collocated closer to the consumers they serve. While we've made progress, further changes will be made to accelerate improvement.

We're reducing production costs ensuring the ads we buy are reaching intended consumers at the appropriate time and place. We're driving media transparency to reduce waste and lower costs. We estimate we've eliminated significant media waste over the past year and reinvested those savings to increase reach by 10% and to (30:48) programs by about 50%.

At same time, we continue to reexamine our organization structure to identify new opportunities to improve productivity, reducing corporate, central staff, and reinvesting in resources closer to consumers and customers. We're focused not just on cost productivity but also on cash.

An important cash productivity project has been supply chain financing, which we continue to expand. This program, which is a win for suppliers and P&G, has yielded nearly $5 billion in cash in the five years we've been driving it.

Productivity improvement will be critical to fund investment for sales and market share growth while continuing to expand profit margins. Alongside the productivity work, we continue to evolve our organizational structure and culture to position us to win in the changing retail and competitive landscape. Clearly, we have learned and we're acting on having more resources closer to consumers we serve with higher accountability, more agility, and greater speed.

We're now nine months into the implementation of the end-to-end and freedom within a framework organization model, simplifying the structure and clarifying responsibility and accountability. We're still in the early stages of the new design, learning, improving and reapplying success models as we go. I want to give you just the best evidence that I have that it's making a difference is what we've done in Greater China. We moved from minus 5% sales growth two years ago to plus 6% fiscal year-to-date. And I certainly recognize we plan more changes will be made to ensure we're winning across a broader share of markets.

We've talked to you several times about the changes we're making in mastery supplementing our internal talent with skilled, experienced, external hiring, and we'll strengthen our compensation and incentive programs. We've talked about how we're increasing the granularity of bonus programs, tying them much closer to results individuals deliver. And based in part on shareholder input, the Board's Compensation & Leadership Development Committee has modified the Performance Stock Program to include relative sales growth metrics and a Total Shareholder Return modifier to ensure awards reflect performance versus external competitive benchmarks. We're also exploring additional opportunities to adjust incentive comp to drive greater accountability including increasing the amount of compensation at risk and more closely linking incentives to team individual performance.

Now while the current environment presents several challenges, we are making progress, we are delivering our financial objectives and we remain committed to improve results in Baby and Grooming while advancing our strategic priorities in continuing to drive productivity. Again, it is not business as usual, and we are taking the additional steps to drive change. Our efforts to focus and strengthen our portfolio to extend our margin of competitive superiority, to transform our supply chain, to enhance our industry leading margins and to simplify organizational structure and increase accountability are all clearly aimed in delivering balanced top and bottom line growth that creates value of the short-, mid- and long-term.

And with that, Jon and I will be happy to take your questions.

Q&A

Operator

Thank you, sir. Your first question comes from the line of Steve Powers with Deutsche Bank.

Q - Steve Powers {BIO 20734688 <GO>}

Hey. Thanks, guys. Good morning. Clearly, there are a number of near-term dynamics that play the – I'm sure will be in focus throughout the call, pricing and the Merck acquisition probably front and center.

But David, I wanted to take advantage of you being here and just step back for a minute building on some of the comments you just made. Because when I think back to when you came in as CEO in late 2015, you had a definite vision to return P&G to stable, profitable and market share positive growth. At the risk of oversimplifying, I think calendar 2016 was to be an investment year; 2017, a year of stabilization; and 2018, a year of acceleration towards sustainability going forward. I mean, even just six to nine months ago, the plan was very publicly said to be working and we were supposed to be accelerating into the fiscal year-end.

So, while I appreciate the incremental call to action today, it just feels that with the results today, and the updated outlook, we're just a good ways away from that outcome. And I guess the question is, 2.5 years in, how do you, how does the board, how does the rest of the management team assess just the overall state of P&G's turnaround? And from here, what's the definition of success? And how long should investors expect to wait just to get there?

So, I think we all get the external challenges, and we definitely appreciate the organization's efforts to-date. But at the same time, we have been expecting more from the investments made these past few years. I'd just love your perspective. Thanks.

A - David S. Taylor {BIO 15435092 <GO>}

Very good. Thanks, Steve. Just a couple of comments. One, I would say we had, and we have today, a meaningful acceleration on eight of our businesses, and I feel good about those. Eight of our businesses now are growing over 3% and the profits are very strong. Core EPS on those – if I look at that part of the business – would be strong.

We had two that have clearly been a bigger challenge than we anticipated, than I anticipated. The steps that we're taking are showing signs, but it's taking longer, and that's going to require more change and more interventions and we're taking those at each one of the brand country combinations in both Baby and Grooming to get them turned.

What I've seen though that I think reinforces that P&G is turning is just the breadth of brands, countries that are showing now strong growth and it's showing up in share with the exception of again those two categories. I don't think investors should wait very long. I expect next year that we will turn. And I think right now, the critical part is to ensure that Baby Care and Grooming execute their plans and the interventions that are planned and that we also continue to make, and we will continue to make, changes as needed as new market realities come forward.

The last six months we've seen improvements in many really important areas and it's P&G getting in a very real way into the natural segment, P&G addressing some of the fastest-growing segments. Now it's in the first time in many years where we're starting to see majority of our top 20 markets turning. China is growing now in the mid-singles as we said it would; Japan, strong growth in the mid- to high-singles. The majority of our top 15 to 20 markets are turning. So, we do have some issues, we understand them, and we're making additional interventions to address them.

Operator

Your next question comes from the line of Lauren Lieberman with Barclays.

Q - Lauren R. Lieberman {BIO 4832525 <GO>}

Great. Thank you. Good morning. I wanted to ask a little bit about the ongoing inventory destocking that's seemingly not in the U.S. We're comping some big destocking. It was an issue last quarter as well. Clearly, we keep track of what retailers are having to say, but I was also wondering to what degree this is reflecting specific dynamics with some elements of your P&G-specific portfolio. Not just overall industry destock, whether it's like you mentioned – you mentioned Harry's by name, but Harry's getting distribution at Walmart, if there's some shelf space loss for Gillette, retailers making efforts with private label. What's happening with shelf space there? And maybe even in Beauty where you've got retailers like sourcing their own product in terms of disruptor and upstart brands, and may be pressuring some legacy shelf space.

So, I just was curious about that as a dynamic more than just retailers trying to manage inventory for their own efficiency, but it's really a statement around how the brands are performing and what takeaway is looking like. Thank you.

A - David S. Taylor {BIO 15435092 <GO>}

I'll give a comment and, Jon, if you have any to jump in there. If I look just at the U.S., recently we've turned to kind of right at flat and actually it's plus 0.1. Your comments though were very fair. We have seen a couple dynamics that I think you're hearing from us and probably from others. The pressure on retailer trade margin is real. The pressure and increased emphasis on private label is very real. The solution to that is innovation that grows categories and at that I think we're actually well-positioned but we have to do even more. And as we've done it, we have certainly seen progress.

I don't believe that the end of just the modest inventory reductions as everybody works very hard to improve the supply chains and we anticipate that and we're looking at that next year. We have seen more adjustments than planned this year as we've commented on.

The key, to me, though, in each one of these categories is where we've demonstrated we can bring new ideas, not mentioned before the Fabric Care example where we come in with whether it's Unstoppables or whether it's coming with just base laundry upgrades or new line extensions. We've been able to grow the category and grow share. The challenge is in all these categories to do the same.

After several years, we're seeing Olay really start to take hold, both in U.S. and China. But what is required was the rethinking of the communication model of our in-store presentation and in many cases, new items that appeal to consumers, the most recent launch is doing extremely well.

So, I believe category-by-category, you have to look at. And while there is an inventory destocking, I believe the fundamental winning and losing will be determined by do you have a consumer proposition that is preferred and do you have a customer proposition that grows the category and helps create more margin. And there's a lot of pressure on that right now as the profit pool is being pressured because of dynamics that exist, that you're well aware of, both from discounters and from the e-commerce side and we have to deal with that.

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

There is one other thing, Lauren, that we're proactively contributing to this inventory reduction, and that's the supply chain transformation that David talked about. And with our ability now to source – to have 80% of our sales sourced within 24 hours from production to shelf, there's less system inventory that's required, and that's a good thing over periods of time. So, there is that element that's contributing as well and that's certainly U.S. dynamic but increasingly a dynamic in other parts of the world as we transform the supply chain to better serve our customer base.

A - David S. Taylor {BIO 15435092 <GO>}

Thank you.

Operator

Next, we'll go to Dara Mohsenian with Morgan Stanley.

Q - Dara W. Mohsenian {BIO 3017577 <GO>}

So, David, your comment in the release about the ecosystems in which you operate being disrupted and transformed and some of the commentary on the call and your presence all seems to sort of be highlighting a change in tone. And I guess, my question to you would be, do you think there's been a material change in the profit growth outlook for the categories that P&G competes in, in the U.S. and globally versus what you would have expected a couple of years ago? I mean, you're porting to some problems in Baby and Grooming, but you had negative pricing in every single division this quarter. That's despite a commodity spike. That's not the way branded CPG companies are supposed to operate. Organic sales is weakening despite a lot of that great internal work you've done to strengthen the organization over the last few years. And what I'd argue is the theoretically great macro environment for the U.S. consumer and what's a key geography for you.

So, I just want to understand, would you agree there has been a change in the sort of profit growth algorithm for the industry or the categories you're in? And then how does that affect your expectations for P&G's longer-term EPS growth, the willingness to invest behind the business and see capital allocation decisions in terms of if M&A and diversification plays a greater role going forward? I know I'm cheating and asking multiple questions, but I think they're all related and important for your shareholders, so, thank you.

A - David S. Taylor {BIO 15435092 <GO>}

You'd asked many big questions. I'll give comment, John will comment, and we'll see if we can hit some of this. What is clear is what it takes to win has gotten more difficult. Do I believe that the profit availability has changed dramatically? No. And I look at some of our probably highest margin and part of the business to invest, whether it's SK-II in the West Coast or our Total Beauty business, is making very good progress. Our Fabric Care business globally and in the U.S. is making very good progress. So, I think what it takes has gotten more difficult and, to me, that should actually favor over time, companies that have tremendous technology and can differentiate through a dimension of superiority that matters to consumers on the five elements. But I've got my eyes wide open that it's going to take additional funding to make that happen, and that's why we do have to change faster.

I am on the call because, one, I think the healthcare change is a meaningful positive step. And secondly, I want to be very clear, it is not business-as-usual P&G, but it's not because in any wide way (44:50) does it take away from the future. It actually just reinforces how we've made the choice that we're going to make additional changes to accelerate and get back on positive, both share growth, top line growth and bottom line growth.

There are many things that are working very well in the company. A few are not, and those we're going to work. The kind of the theme is we're growing through some tough challenges right now, but the fundamental strategy and the profit potential, I think, are very much still there, just requires faster moves.

And one other comment on this and just to illustrate is we had many questions a year ago on China because we come off a very difficult time. And there, we did have to move in a different way than the past a number of capabilities directly in the market and what we've seen is there are almost instant reaction from the minus 5 to plus 1 to the plus 6.

In the U. S., we've got many categories also turning. We have a dynamic in Baby Care that's very difficult, and we're addressing it. We had a dynamic a year ago in Shave Care, and we're addressing that and you're starting to see the last one in three month's meaningful improvement.

If you got consumers coming in and you've got innovations that delights them, we've seen consumers are willing to pay. Interestingly, the fastest-growing segments around most parts of the world are premium, super premium, new forms, naturals. All of those tend to carry very good profit margins and very good growth rates. We do have to continue to transform our portfolio to increase the percent of our business in those forms. And one example that's playing out across the world is Pants and Diapers even though it's been a difficult category, I'm very pleased that we're leading in the fastest-growing segment that consumers around the world are choosing for their babies.

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

I think the only thing I would add to that, Dara, are two points. David made a point in his prepared remarks that I think is very important that talks to the benefit of noticeable superiority, packaging products, communications, go-to-market, et cetera. And where we have that right, we're delivering our business objectives all the way from household penetration to market share, to profit growth the vast majority of the time. And where we don't have that right, it's very clear we're not delivering against those objectives.

So, that's not a macro dynamic and that scenario that's holding us back it's increasing the level of advantage that we need to with our current portfolio which, as David said, we then use productivity to help fund.

The other perspective I'd give you, and this is not in any way an excuse. It's perspective on whether there's a systemic issue here or not from a market level standpoint to the point of your question. If you look at – and David mentioned this earlier as well, if you look at sales growth, excluding Baby and Grooming where we know we have work to do, we're 3% fiscal year-to-date; profit growth, 9% fiscal year-to-date. So, there's nothing as we look at the totality of the portfolio that indicates to us that those kind of results aren't available on a broader basis.

Operator

Your next question comes from the line of Nik Modi with RBC Capital Markets.

Q - Nik Modi {BIO 7351672 <GO>}

Yes, thanks. Good morning, everyone. So, I guess the question – maybe, Jon, you can answer this on category growth, how that's looking relative to where we were the last time you had this call three months ago. And if there's any way you can give us context between volume and pricing, because it looks like pricing has broadly been deteriorating across entire industry?

And just related to that, you talked a lot about the competition. It seems like the emerging markets, the local players are becoming much more sophisticated and much more of a nuisance for you guys and other multinational companies. So, just wanted to understand if you're changing anyway you're making decisions to help compete against those local companies a bit more effectively?

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

So, let me comment on the market growth dynamics, and we'll have David comment on how we're responding to evolving competitive realities. Market growth within the last quarter is essentially unchanged in aggregate from when we last talked last quarter. It's about 2.5% in our categories. That's comprised of mid-singles in developing markets and low-singles in developed markets. So that's the status on market growth.

Pricing, as I talked briefly about in my prepared remarks, is also essentially unchanged versus when we last talked. There's 30 basis points of additional price but I don't think – and clearly, I mean with the retail dynamics that are occurring, there is pressure on price. But where we can bring meaningful benefit superiority to market, we're seeing the ability to price.

PODS are a premium-priced item. Beads are premium-priced. The naturals elements items that we're bringing to market are premium-priced. So, to the innovator, there continues to be a pricing opportunity.

A - David S. Taylor {BIO 15435092 <GO>}

And let me comment a little bit on emerging markets. And I'll use China because it's the biggest one and have the most comprehensive data on that, and I'll just spend some time going through that market carefully with the team.

We have, and if I look at kind of where we are losing share, where we're gaining share, you're absolutely right, the greatest share losses in difficult periods have been kind of all other companies are local and regional competitors. But even that, I've seen change over the last – if I go back two years ago, a year ago, to more recently, and then take almost category-by-category, Fem Care definitely was being hit by Hengan, which is a local competitor and some other local competitors.

We were indexing for four years between 94 and 95 index. In fiscal 2016, 2017, we grew modestly to 105. We're right now tracking this fiscal year above a 115. Why? We put the pure cotton product out there. We've got the right – the whole line up is right now. And the team has just done a beautiful job one by one, understanding the consumer. We had to re-staff in a way we're – in addition to a strong team, adding the capability to make decisions on the ground and that included having a more fully functional capability there and re-assign people from the center to the market.

The same things happened in Olay, which were for many years, if I go back 2014-2015, 2015-2016, was indexed in the 90s. This year, it's going to be above 110, and it's showing it can accelerate. Now what's happened is it's had to do some things additional to what we're doing in the rest of the market, because you're right, local and regional competitors are throwing a lot of stuff at the market.

I will draw a distinction between where there may be some share gains and where people are creating value and sustaining that. We're showing – again, whether it's Fem Care, Oral Care, our Personal Care business, one by one, getting better which is why in aggregate China is sixth and actually Mainland China is a little better than that, that's our Greater China unit, Mainland China is a point above that, is we can win against a very aggressive set of competitors. What's different is the innovation cycle is much shorter, the speed of decisions has to be faster and we've had to reorganize to make that happen. That's part of the end-to-end but go much more aggressively in China.

India, which is another market, is very, very difficult. And you see in the India market where the whole world went through the two big transitions last year, we're now double-digit this year, doing the same thing, making sure we have the right go-to-market capability for that specific market. And then making sure we've got superior consumer preferred, both products – and one of the biggest changes is giving more latitude to the market to adjust the communication to meet and communicate with the local consumer.

So, actually, I do believe that has been, but I've got a lot of evidence we can win. When China and India, the two biggest markets, we're now starting to grow and we'll grow it at an accelerated pace as we go through the fiscal year.

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

And I think as well, just reflecting on China for a second, to your question, Nik, about price potential on a global basis. I mean, that's a market we're at a market level. The premium and super premium tiers are more than 100% of the growth of the market, which continues to be very attractive in total. And our business as well in that market, David mentioned Feminine Care, is growing fastest at the premium portion of the market. So, as we look globally, there continues to be significant opportunities for growth from a sales standpoint and doing that very profitably.

Operator

Your next question comes from the line of Wendy Nicholson with Citi.

Q - Wendy C. Nicholson {BIO 2081269 <GO>}

Hi. I had a couple of questions but they're short and discrete. So, hopefully that's okay. First of all, on the private label growth in the diaper market in the U.S., are you seeing that more in-store or is that an Amazon phenomenon?

Number two, is the fact that you're buying the Merck business, does that mean or imply or suggest that you won't be buying a big piece of the Pfizer business?

And then, third question is just on the guidance for pricing to remain negative in aggregate for the next several quarters, but the gross margin is supposed to be up in the fourth quarter, if I heard that right. That just seems strange to me, not only given the negative pricing but all of the commodity inflation we're seeing. So, can you explain from a productivity initiative perspective, like what's the light switch that goes on in the fourth quarter that's going to get gross margins up? Thanks.

A - David S. Taylor {BIO 15435092 <GO>}

Yes. Private label, what we are seeing is an acceleration of support. I'm seeing more of it actually in-store in some of our retailers, and I think in part due to defending versus the Lidl and Aldi launches that have continued to expand. And because of the importance of that consumer, all the retailers recognize getting the young mom is important for the basket. And because of the profitability pressure, there's a lot of movement there.

What we have to do and are doing is making sure our products are preferred, and that's the best way to win versus private label and we've demonstrated that in Europe over a decade, and we're going to have to sharpen and speed up in terms of some of the changes that we're making to make sure we win with the U.S. consumer. But it is I think a reaction to two dynamics both online and the discounter moves that have occurred in the last year.

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

For the baby diapers specifically, it's disproportionate offline versus online. So, Amazon, for example, is not a huge dynamic in that category other than, as David said, it's influencing the behavior of other retailers.

In terms of your question on pricing and commodity inflation and productivity and gross margin, pricing will remain a negative impact to top line for the next quarter. That's as far as we've guided at this point other than I do expect it to turn positive sometime next year. But the amount of the impact should lessen over time. And one of the big drivers, Wendy, is simply that we annualize the big Gillette U.S. pricing reduction starting now.

Also, productivity, as we've talked about, tends to be back-loaded, so it increases as the year progresses and we bring on additional savings. David mentioned, for example, the start of production in West Virginia. And so, I feel reasonably confident that we can grow gross margins in the face of continued price impact on the top line albeit at lower levels.

Sorry, you also asked – the trouble with multipart question is I forget. You also asked about acquisitions and as you readily appreciate positively or negatively, that's not a topic we comment on.

Operator

Your next question comes from the line of Jason English with Goldman Sachs.

Q - Jason English {BIO 16418106 <GO>}

Hey. Good morning, folks. Thank you for allowing me to ask a question. I guess, a few potential questions on the table but I want to come back to the pricing one. The narrative of premium tier is driving growth isn't really new nor is the narrative of you upgrading your portfolio and innovating into those premium tiers. It clearly and resolves (58:19) your price mix is eroding. And if you look at Nielsen, down in the U.S. – you sold more in promotion in the U.S. last quarter than any time in the last five years. And obviously cost, your European competitors facing FX. Historically, this has been fairly accommodated (58:33) pricing.

So, from the outside looking in, it seems like you're chasing a price value equation lower in the wake of all of this disruption that you're talking about on the retail side, the competitive front as well. None of that disruption looks like it's poised to abate anytime soon. So, why should we expect price to improve going forward? Why shouldn't we be assuming that this is sort of a new reality and maybe looking to address the business model, the cost structure more aggressively to adapt to this new reality?

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

Well, I'd say there is some element of new reality there, Jason. I think that's a very valid point. And as David said, this is not business as usual. So, we're changing everything to adapt to that new reality, whether it's entering segments that are new segments that also carry premium prices that are going fast like the natural segment.

We talked about ever-increasing levels of productivity to be able to allow us to continue to invest while holding and building margins $200 million to $300 million ahead of our going-in target this year. And I expect we'll have a very aggressive plan next year as well.

So, we want to be prepared to win in this scenario where this is a continuing dynamic. But again, in many parts of the world, it's a very different market reality, and in those markets we need to position ourselves to win with those consumers.

A - David S. Taylor {BIO 15435092 <GO>}

Yes. And just the only thing I'd reinforce is and maybe I haven't as clearly communicate as I want to, we do recognize changes must be made and that the cost structure demands are real and are more than the past, period. That's real. And what we had anticipated is not sufficient, therefore, we need to do more.

I do believe that the strategy is right. What it's going to take bring to life and deliver the outcome we want means we're going to have to do more things differently than we've done before and we look at some choices we've made to make sure that they'll make the needed progress over the timeframe we're talking. And to me right now, that is going on in our company and will continue to go on in our company because there is a reality that you've got, whether it's on the discounters, the e-commerce, retailers, all working hard to make sure they get their share of the value created in an industry. And the winners are going to be the ones that have products consumers want more than anything and the ones that can help grow markets and help the retailers grow margin. And to do that, we're going to have to have more investment available, and that's going to come through our cost structure.

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

And this also isn't a dynamic that's new. We've talked before about, for example, what happen when the discounters expanded in Europe and private label shares grew significantly as a percentage of the market in Europe over the last 20 years? And our business went through peaks and valleys. It wasn't an easy adjustment, but we made the adjustments we needed to make, and our business has performed very well in that context, building share and the vast majority of our big brands and categories in Europe over that period of time. That's no guarantee for success with the current dynamic in the U.S. We certainly don't approach it that way, but it's also a reason to believe that it can be done.

Operator

Next question comes from the line of Olivia Tong with Bank of America Merrill Lynch.

Q - Olivia Tong {BIO 7481692 <GO>}

Great. Thanks. David, you went through a number of initiatives around Baby, Grooming, a few other categories. Most of the moves seem to be around pricing and promotion, less around products. So, as the market leader in the majority of your categories, why do you think that these are the right moves and why do you believe they're not potentially contributing to taking even more dollars out of these categories?

And if I could just follow up on an earlier question on margins, a lot of pressure right now on gross margin obviously and those pressures seem to be growing, maybe pricing less as Gillette actions lap but you've got negative mix, the freight issues, et cetera, that you're dealing with. Do you think that there's enough productivity benefit next year to offset these to get gross margin expansion as we look out to fiscal 2019? Thank you.

A - David S. Taylor {BIO 15435092 <GO>}

Well, first, I – we will make pricing adjustments where we've lost consumer value, but that is not what – how we lead. That is not our lead strategy. Our strategy is to delight consumers and actually trade consumers up. And in Baby Care, the fastest growing segments are Pants and premium taped. What we have to do and are doing is innovating on those platforms. What has taken more time than I would want is to get the platforms in place and the cost to optimize as we get winning products out. In Pants, the product is winning and we're growing share and the category is growing fast.

We've got a large install business on mainline across many countries, and that segment is under tremendous pressure. And you are right, that part of the business is very pricesensitive. And as we get more and more of our portfolio in the premium and super-premium segments, we actually insulate ourselves from some of the issues that you're talking.

The same is true on Gillette. As we continue to trade people up, then we have stronger profitability. Where we were missing and what required this intervention was we were losing too many users. And over the long-term, that is a real problem. And so we had to strengthen our innovation on all three tiers, disposables; the mid-tier systems, which is Mach; and the premium systems, which is the Fusion family.

Each of those has innovations. In the past, we only innovated the high end. The risk in that is you lose users, and losing users over time was the issue. That led to the intervention. But on both categories, our pricing interventions are meant to be very competitive. Our strategy to win is on premium, super-premium and superior products.

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

And on your question on margins, we're just in the beginning phases of putting our plans together for next year, Olivia, so I don't want to provide specific guidance. But our objective clearly will be to continue margin growth on both the gross and operating margin line.

We will be just as we did this year, looking to increase the level of productivity savings that we can bring to bear in that situation. And I expect as well, if the commodity trends continue, that there will be pricing in some categories and some markets to help offset this as well.

Operator

Your next question comes from the line of Ali Dibadj with Bernstein.

Q - Ali Dibadj {BIO 15328592 <GO>}

Hi, guys. So because there are two topics, M&A and obviously kind of your core business, maybe you'll indulge me with two questions. One is on the M&A, why is this the right time to do the Merck OTC deal – Merck (01:05:52) deal? You have so many other things going on. It was not a cheap valuation, some would argue. It doesn't really move the needle. Was it really that the kind of Teva either pulling out, are you guys deciding that JV doesn't work, does that really kind of precipitate? This is the first question.

And then the second question, building up some of the themes we've been talking about, I guess I'm wondering what plan B is. And you may say it's too early to talk about that, but there's a (01:06:22) a little bit of drama about acquisition for sure and it comes up to be much smaller, compelling talk of change. Again, you guys did a really good job, your marketing organization sort of talking about change. But I don't know if we can make much bone to batter (01:06:35)?

I mean, the actual numbers aren't good, right? Your pricing guidance was down 2%, and this is after quarters and quarters and quarters of talking (01:06:43) innovation and no price wars when we've heard shareholders ask this question, recently ask this question. And by the way, it only becomes positive, it sounds like sometime the next fiscal year in terms of the pricing, but that just doesn't feel good.

You said, look, we're 8 of 10 are good, two of them are not good, into your categories, but there's always two that are not good, right? I mean, it just seems like there's always something wrong with P&G. Some category combinations are doing well, which impacts the whole business. It hasn't come together. We get that. But I guess, why will it now continues to be the question we ask. And you say, look, it's not business as usual, but we've heard some form of it's not business as usual for at least five years.

So I guess what if the strategy doesn't work? What if the world is actually too dramatically different? HPC starts to look like packaged foods from investors' perspective, what is plan B? What are the things you guys think about as a ripcord option? And is it just don't innovate? Is it shed your head count by 80%, not 25%? Are you just going to have to accept and we're going to have to accept your over earning? I really want to get underneath this plan B part as well, please?

A - David S. Taylor {BIO 15435092 <GO>}

Let me take, there is lots of questions and commentary there. First on, is this the right time. This was a very good transition – the Teva, and you're probably familiar with the situation right now with Teva. In our discussion with Teva, it was clear that the ongoing – the future of the JV needed to change. And that's been one of the strongest parts of the business.

At the same time, Merck complements what we have and strengthens what is left once we separate from Teva and gives us a better geographic footprint. It gives us some additional therapeutic areas. They are growing in the mid to high single digits. And you put the two together, and this transition gives us a stronger business in a category that's got attractive margins and strong growth rate.

It's a positive mix for the company. If you look on a go forward basis, and they – these things happen when they happen. And there was an opportunity, and I'm very pleased we got this done. And I think it's very positive for P&G shareholders for the future. The – and we don't pick the timing on when all these things happen. There's other parties involved. But when it does, you get it done. You get it done right.

The second one is – you had many, many questions and some comments in there. Just a comment on there's always some business, we certainly recognize that. And through our history there's always been some businesses up and down. We have two particularly large businesses that have had particularly meaningful parts (01:09:30).

The changes over the last couple of years show the level of breadth that indicates P&G can win across a wide range of markets and a wide range of categories. I completely accept that we must improve the aggregate P&G Company, top, bottom, and share. Cash performance has been very strong, and we're making the interventions to do that. Will we look at more significant interventions and how we're organized in taking cost out? We've already addressed that. Yes, we will, in ways to create the productivity savings in order to make the interventions needed.

I don't think there is a broad HPC industry can't win or can't generate value. I don't buy that scenario. And I believe it's just incumbent upon the leaders in the categories to come up with the innovation that does create value. And there's periods you go through in a category that are difficult. And the winners are the ones that come out with fundamentals that are strong, consumer-preferred products. And it has to be done even more than in the past in a way where the retailer sees category growth and margin growth. And that requires again additional productivity to fund it. And what we're doing is adjusting and, in some cases going to have to do a meaningful additional effort to make that happen.

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

And just back to timing on Merck. We've been trying to communicate this morning that we realized that we're operating in a world that is changing, and we need to change with it. And we can't, in that context, ignore work or complexity that we take on in order to make those changes.

And one of those changes has been, and will continue to be, increasing the attractiveness of the footprint of the portfolio. And OTC is a very attractive space for us. This opportunity became available. We embrace the change opportunity that it represented, both the sun-setting of the JV, which has been very successful, and this new opportunity. And we'll continue across our activity system to take on necessary change to improve outcomes.

Operator

Next question comes from the line of Kevin Grundy with Jefferies.

Q - Kevin Grundy {BIO 16423871 <GO>}

Thanks. Good morning. David, just sticking with the topic of M&A and, of course, I appreciate you won't comment on specific assets that was brought up earlier. But in light of this acquisition and many of the challenges that have been discussed, does M&A play an increasing role in the capital allocation strategy to move into categories that are growing faster, particularly than some that are challenged in the existing portfolio? I was hoping you could touch on your M&A criteria, maybe the appetite for potentially larger deals, maybe that's not what the company needs point at this point. I think there's some merits to that argument, and then potential categories, geographies of interest.

And then just the last part of that just given the significant amount of portfolio pruning, which just happened over the past several years, can you just confirm that the areas of interest are only within Procter's existing 10 that are in the portfolio at this point in time? Thank you.

A - David S. Taylor {BIO 15435092 <GO>}

What I would say and that there's so much I can say about future and about M&A. The core growth will come from organic sales and profit growth within our existing portfolio. We are open, as demonstrated by the announcement today, when we see an opportunity to create value, especially if it cause us to play in a category that has very attractive demographics and to me, structural profitability.

And I'd just say we stay very open. I think you also said are we looking a lot outside our 10 categories? The key is to stay focused on the 10, but look for ways and there may be some adjacencies that leverage core capabilities of the company. And for those, I would be open as well. But again, it's not a C-shift to say primarily driven by – or growth by inorganic approaches, no. But a level of openness probably there's more in the past because we finished the portfolio pruning and now we believe each category ought to be active managers of the portfolio.

Operator

Your next question comes from the line of Bonnie Herzog with Wells Fargo.

Q - Bonnie L. Herzog {BIO 1840179 <GO>}

Thank you. I just have a quick question regarding macro indicators such as consumer confidence really are at or near highs, but category growth still remains quite weak. So could you guys help reconcile this for us and better understand the disconnect between these factors?

A - David S. Taylor {BIO 15435092 <GO>}

The category growth varies widely. It stayed strong in China. It's picked up in India. The U.S. has been difficult, and part of that is aggressive pricing action is taken place with some of the dynamics we've talked before between online and offline and a couple of big, highly contested categories with Baby Care being the best example I can think of, where many are after that consumer and have been well under-priced pretty aggressively, even different from what we may sell to them, and that kind of goes up and down.

I do believe in most markets around the world, we're seeing actually stable to, if anything, slightly improving, and that's because of the progress in India has been a big plus. A couple markets, and Jon mentioned one earlier, that has been a real challenge. The markets like Saudi have contracted a great deal, and that's via a choice by the government to focus on the Saudization and the diversification of the economy. And we've seen that hit both Saudi and has had an impact on the Gulf states. And there's always been volatility in Africa.

But if I look at Europe, stable. If anything, slightly improving. The U.S. in terms of volume is stable and in some categories, improving. Pricing is difficult right now. And Brazil, the outlook by most would be improving in the future, difficult the last few years, coming out of two years of a severe recession.

Mexico, stable and pretty solid. And, who knows, I think Russia is impacted pretty heavily by some external events that are going on right now. But I don't see a weakening of the global consumer demand. If anything, probably, just sequentially a modest improvement outside the U.S. and stable in the U.S.

Operator

Next, we'll go to Bill Chappell with SunTrust.

Q - Grant O'Brien

Hi. This is actually Grant on for Bill. We just had a question on the Grooming segment, and kind of the entrance of that value-tiered player into a large U.S. retailer. I guess our question is more on kind of that player entered into another U.S. retailer this past year, and I was wondering maybe what the impact of that was on your business then. And maybe if there's any additional pricing pressure going forward due to that entrant in that retailer? Thanks.

A - David S. Taylor {BIO 15435092 <GO>}

Well, the entrant that is going to another one is right already present. When they first came was coincident. Well, actually right before we took the pricing action, and the issue was we were not serving consumers in the below $10 price range. We didn't have what we needed at the $7.99 and $9.99 price point. So when came into one of the large U.S. retailers and it did have an impact.

Post the intervention we've made, as we said, our volume has picked up. So we entered this next phase while it still will be a challenge, we have the portfolio now where we have key price points covered. We've got innovation going in across disposables, the mid-tiers and the premium systems. And we're in much better place to compete, and we're also taking aggressive defensive actions to take make sure that we communicate with our consumers.

The fact that the volume is improving is a positive sign. The fact that even the past one in three months, value shares is improving is positive. We'll have another challenge when they first enter, and – but we're in a very different competitive place in Grooming and our eyes are wide open this time to make sure we defend our business aggressively.

The same is true on some of the online entries in Europe. Well, this time, we're going to defend our business and work to keep our consumers and certainly attract consumers that are interested in online experiences. We recognize that the competitive environment will continue to be challenging. All that just means acceleration, make changes that are needed, and if what you're doing doesn't work, be open to new ideas, and we are.

Operator

Next question comes from the line of Jonathan Feeney with Consumer Edge.

Q - Jonathan Feeney {BIO 2268157 <GO>}

Hey, thanks very much. David, you mentioned the user base in Grooming a couple of times, and come back to it in the Q&A, the need to hold onto these users. I mean, what if it's the case that fragmentation is just natural here and the kind of users who want a more low-end experience just aren't great 20-year Gillette customers and that there's going to be a next wave of innovation that takes care of this?

And what you need is higher prices and a higher value and to pull consumers up. I mean, I know that that sounds like pie-in-the-sky at this point with all these new entrants, but I also observed that I'm doing this for 17 years in food, beverage, HPC, I can't think of a time when an absolutely dominant global leader with a price premium has kind of healed the category by taking price and profit out of it, that's scared, that's basically restored order in light of what's happening here. What has convinced you that – or what is it that makes you want the user base to be higher at the expense of profits? And what data do you see that makes you think that's the right answer?

A - David S. Taylor {BIO 15435092 <GO>}

I think there's a good bit of data. If you look at Gillette specifically, when consumers enter the Gillette, I'll call it the portfolio ladder, we got a lot of evidence that the experience is better than what they were using before at whatever price tier, and then we can expose them to the next level up in performance and consumers move up.

And so what was problematic was if you're losing too many new consumers certainly at a time where there's some societal trends around the frequency of shaving, you put those two together and said, we're not going to sit by and watch a significant portion of new users, more millennial consumers not being exposed to Gillette and get on habits that one don't give them the best consumer experience, and secondly, would compromise the brand.

So then we made the interventions. It did bring the volume back. And again, we've got a lot of evidence over time. And if you think about almost any category you get in. If you're pleased with the performance of the product when you enter, you are open then to ideas from that – ideas and products from that brand.

It is to be a losing strategy to have a smaller and smaller group of consumers playing more and more, and believe that will continue and grow your business at acceptable rate. And that's why we want to play in the premium and super-premium, but we also have an appropriate entry in most of our categories to bring consumers in and then give them delightful experiences that they're happy to pay more. And that's true in the 8 of the 10 categories working. It's also why we start early, and with Pampers with great products, but we also have Luvs or mid-tiers as we want to be present to bring consumers in. But then once they are into any one of our brand franchises have a meaningfully better experience and give them the choice that they're willing to trade up, and we got a lot of evidence over time on a lot of categories that they will. But you have to be price competitive at the point the consumer enters the category.

Operator

And now your final question comes from the line of Joe Altobello with Raymond James.

Q - Joseph Nicholas Altobello {BIO 5113646 <GO>}

Thanks guys. Thanks for squeezing me in and I appreciate it. Just wanted to go back to the shift in and it's just (01:22:40) the private label on the part of retailers in certain categories. I certainly get the fact that you see better margins for them, but it's always been brands that really drive traffic. Is that a commentary on the impactfullness of innovation by branded players like yourself in certain categories, or does the consumer simply value product performance differently today than they did three or five years ago? Thanks.

A - David S. Taylor {BIO 15435092 <GO>}

I don't think there's a fundamental difference from the consumers valuing or seeing private label differently. I think private label has improved their quality, and I think we have to maintain a level of advantage to justify the price premium. It's as simple as that.

When we do that and do that well, we've got all kinds of examples. We're able to earn the consumers' trust and the additional cost is actually a good value for them. I expect the private label manufacturers will continue to – and what they generally do is, is look what the large manufacturers are doing about the branded players, and they will add new features, and we need to be innovative in bringing new ideas and meaningfully better performance.

It is so fundamental to why the strategy of meaningful superiority has to be implemented. In the categories where we've done that, we're seeing just what you'd want to see and we want to see. Top line growth that grow share. Bottom line growth that creates value in the higher single digits. We've got a few where that isn't the case and a few were very large, and that has weighed down the company.

But when achieved, the strategy works. The challenge is to achieve it more consistently in more brands across more countries. And while we have those, we have a few big rocks still to move, and we've been very open about what those are and we're willing to take additional actions, and we will take additional actions to make sure we have the funding and the capability to make that happen.

Operator

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