Q2 2018 Earnings Call

Company Participants

- Jon R. Moeller, Vice Chairman & Chief Financial Officer

Other Participants

- Ali Dibadj, Analyst
- Andrea F. Teixeira, Analyst
- Bonnie L. Herzog, Analyst
- Dara W. Mohsenian, Analyst
- Jon R. Andersen, Analyst
- Jonathan Feeney, Analyst
- Joseph Nicholas Altobello, Analyst
- Kevin Grundy, Analyst
- Lauren Rae Lieberman, Analyst
- Olivia Tong, Analyst
- Steve Powers, Analyst
- Wendy C. Nicholson, Analyst
- William B. Chappell, 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 going to start with a brief review of the company's results for the October-December quarter and discuss progress against our key strategic focus areas. I'll update our outlook for the fiscal year including the impact of the recently enacted Tax Cuts and Jobs Act, and I will open the call for your questions.

Results for the quarter were in line with our going-in expectations and, as a result, we remain on track to achieve our fiscal year objectives. Organic sales grew more than 2%, an acceleration of more than 1 point from last quarter. Sales increased versus year-ago in 14 of our 15 largest markets and in 8 out of 10 categories.

This growth occurred against some significant headwinds. The U.S. Gillette pricing interventions reduced organic sales growth rate by about 30 basis points. There was also a 40 basis point impact from the combination of retail inventory reductions in the United States and the impact from the government of Algeria banning finished product imports into its markets, in total, about a 70 basis point headwind in the delivery of over 2%.

Organic sales growth was again volume-driven with volume also up more than 2%. All-in sales were up 3% including a 1 point benefit from foreign exchange. P&G tracked channel market share trends improved modestly. 27 of our 50 largest category country combinations are holding or growing share, up from 22 for the same period last year. Of those, where share is still down, half have lessened the rate of decline, obviously a positive step towards returning to growth. E-commerce sales continue to be very strong, growing about 40% with 8 out of 10 categories growing market share.

Before I take you through the earnings per share results, which are also on target, let me step back briefly and outline the impacts of the Tax Cuts and Jobs Act. We view the Tax Act as a significant advancement for the competitiveness of U.S. companies. When we started working in along with many others on tax reform, it was in large part a response to the previous administration's stated desire to repeal deferral of U.S. taxes on offshore earnings until repatriation. This was the one element of the U.S. code that helped address the negative competitive aspect of the U.S.' global taxation approach, so we were very concerned about its threatened repeal.

The other issue which concerned us was the U.S. corporate rate which had become one of the highest in the world. With the combination of these items, we were potentially looking at a 35% tax rate on global earnings due immediately, which was more than 10 points to as much as 20 points higher than many of our internationally domiciled competitors.

The U.S. Tax Cuts and Jobs Act addresses both of these concerns by reducing the tax rate on U.S. earnings to 21% and by moving from a global taxation regime to a modified territorial regime. It enables U.S. companies to remain competitive globally, which maintains and creates jobs in the U.S. It facilitates the free flow of capital, and the individual aspects of the Act will hopefully, in many cases, stimulate consumption. That's a very positive change, in our view.

In terms of the math, there are several pieces of this I think are worth walking through. I won't touch on every element but I'll try to help with the largest ones. As part of the Act, U.S. companies are required to pay a tax on historical earnings generated offshore that have not yet been repatriated to the U.S. There's a 15.5% tax due on un-repatriated retained earnings that are held as cash or liquid assets and an 8% tax on earnings that have been reinvested, for example, into manufacturing or our research facilities. We are accounting for the entirety of this tax in the quarter we just completed as a non-core earnings charge of about $3.8 billion.

There are several items which partially offset this charge, the most significant of which is a revaluation to reflect the new tax rate of a large net deferred tax liability position. The offsets bring the net non-core earnings charge down to a total of around $630 million. This is a non-cash charge. The tax on historical foreign earnings is being recognized now for accounting purposes but will be paid as stipulated by the Act over an eight-year period. So, the cash impact will fall in future periods and will be more than offset by the cash benefit from the lower ongoing tax rate.

We will be truing up the one-time charge for any evolution in policy interpretation as we complete fiscal 2017-2018. For example, just last Friday, the Treasury Department provided new direction regarding which exchange rate should be used to calculate the one-time tax on foreign earnings.

Now let me move to core earnings and cash impacts. There are two main core earnings benefits. First is the lower rate on U.S. earnings of 21%. The second benefit is an even lower rate on royalty income that relates to U.S. domiciled intellectual property. Most of our IP is held in the U.S. Overseas affiliates licenses IP and pay the U.S. for its use. This U.S. income will now be taxed at an effective rate of about 15%.

The most significant core earnings offset is the inherent disallowance under the Act of previously available U.S. tax credits. With assumed immediate repatriation of foreign earnings for accounting purposes going forward, we will also be recognizing dividend withholding taxes, taxes levied by other countries as we repatriate cash through intercompany dividends. We're recognizing these as current period liabilities in the period when earnings are generated.

There's a small negative P&G impact from the minimum tax on foreign earnings that is stipulated by the Act and there are other operating impacts, which reduce the rate benefit. One example is the potential need to gross up reimbursements for relocation costs which, under the Act, become personal income to relocating employees. All told, the core earnings benefit of the Tax Act is about $135 million in the December quarter and for the fiscal year. The benefit will more than double to about $300 million in fiscal 2019 and double again to about $600 million per year on an ongoing basis. This phase-in of benefits reflects both the period of the fiscal year for which the new rates are in effect and the amount of credit benefit that had been built into our base plans by fiscal year.

Last but certainly not least is cash. The cash benefit will be about $250 million this fiscal year, $200 million next fiscal year, and $450 million per year ongoing. The ongoing cash benefit is somewhat lower than the earnings benefit because of the cash payments for the one-time tax on historic retained foreign earnings which occur over the next eight years.

So, those are the numbers in a vacuum. The most significant benefit, as I said earlier, of U.S. tax reform for P&G is the positive impact it has on our long-term competitiveness on the 60% of our business that's currently conducted overseas and the reduced barriers for capital flow across markets. I'll talk to impact on earnings guidance and cash utilization subsequently in the guidance section of this update.

And now, to earnings per share results for the quarter, all-in earnings per share were $0.93. This includes $0.02 per share of non-core restructuring costs and $0.24 per share of non-core charges due to the Tax Act that we just talked about. All-in earnings per share declined 68% versus the prior year. This compares and reflects the one-time tax charge in the current period and the very large gain from the Beauty RMT transaction in the base period.

Core earnings per share were $1.19, up 10%. Excluding the $0.05 benefit from the Tax Act, core earnings per share were $1.14, up 6%. Foreign exchange added about 4 points to earnings per share growth and higher commodity costs were a 4-point headwind.

Commodity prices have continued to move higher as the year has progressed, approaching a $350 million after tax impact versus year-ago for the fiscal year. We knew we'd see higher pulp cost going into the year. These costs have continued to increase beyond initial forecast ranges with strong demand in some recent supply disruption.

Ethylene, propylene, kerosene and polyethylene and polypropylene resins have increased recently, primarily as a result of the fall hurricanes in the Gulf but also due to recent increases in crude pricing. Delivery costs have also been rising as demand for drivers outstrip supply.

As a result, core gross margin declined 80 basis points versus year-ago. 150 basis points of productivity savings were more than offset by: headwinds of 90 points from higher commodity costs; 70 basis points of mixed impact; 50 basis points from pricing, primarily Gillette; and 40 basis points of reinvestment in product and packaging innovation.

Core SG&A costs, as a percentage of sales, declined 80 basis points driven by productivity savings of 40 basis points from the combination of reduced overhead, agency fee and ad production costs; and approximately 40 basis points of top line leverage. As a result, core operating profit margin declined 10 basis points for the quarter. Productivity savings were a 190 basis point benefit within this.

The core effective tax rate was 21%, including the impacts from the Tax Act. Adjusted free cash flow productivity was 91%. We repurchased $1.8 billion of shares and distributed $1.8 billion in dividends. In total, $3.6 billion of value returned to share owners this quarter. Net pre-Tax Act core results, in line with our going-in expectations and result with the Tax Act that are ahead.

We continue to accelerate top line growth. We're continuing to increase the number of major category country combinations that are holding or growing share. We're continuing to deliver productivity savings and strong cash flow.

I'm going to move now to progress against our strategic priorities. As you know, we've chosen to focus our efforts on daily-use categories, where products solve problems and performance drives brand choice. In these categories, we're doubling down on meaningful superiority, products, packaging, brand communication, retail execution and superior value in each price tier where we compete.

We've raised our standard for competitive advantage in each of these areas to drive market growth and market share. We're making progress against this new higher bar judgmentally achieving it across all five touch points 40% of the time, up from 30% last year. We'll make further progress in the back half of the year with the strong innovation lineup recently and soon to be launched.

I'll touch on a few examples where progress against this standard is driving both market and share growth. Fabric Care continues to drive category growth with four steps to the perfect wash, reframing the category experience from laundry and fabric enhancers, to four steps that are better together: laundry, liquid fabric enhancers, beads and dryer sheets. This initiative combines strong innovation across the forms and improved in-store execution, visually showcasing the Better Together product line-up at shelf and online with renewed consumer communication.

The U.S. detergent market continues to grow fueled by P&G and primarily by unit dose. New advertising, incremental distribution and in-store communication on the four steps to the perfect wash has driven fabric enhancer category growth to almost 6%, with P&G growing over 10%.

We continue to strengthen our offerings to drive the fastest-growing segment of the Diapers category, which is Pants. This segment makes up 25% of the overall Diapers category globally and is growing over 15%. The majority of the category growth over the next five years will be driven by the Pants segment. Pampers Pants has held the number one global share position for 10 consecutive months, led by sales growth of 30% over the past 12 months behind innovation that is being brought to consumers across the world.

Olay in China achieved its third consecutive quarter of double-digit growth, delivering superiority across all touch points. We completely revamped our Olay Beauty Counselor program and upgraded the in-store counters with higher and tighter standards. A few months ago, we launched Olay cell science, Olay's first-ever super peptide formula, delivering visible skin transformation in 28 days. We've upgraded Olay packaging to prestige-like quality and attractiveness.

Our fearless of age campaign with an empowering message for consumers has further driven consumption, has contributed to strong e-commerce sales that are up 80% fiscal year-to-date, and is growing Olay's market share, raising our game in products, package, communication, point of sale, and consumer value; all leading to strong double-digit growth for Olay in China.

Always Discreet has grown more than 20%, reaching new record share levels across all markets behind the successful launch of Discreet Boutique underwear that look, fit and feel like real underwear. This superior product and strong in-store execution has driven Discreet global value share above 11%, up 1.5 points over the last three months.

Boutique has reached 20% of our underwear business, is 100% incremental to Always Discreet, earning 2 share points where it is distributed. In the U.S., the Adult Incontinence category growth, both volume and value, has accelerated since the Boutique launch, with Boutique driving 60% of that growth.

We continue to develop new Naturals offerings to increase the relevance of our brands and products with the Naturals consumer and the increasingly environmentally-concerned shopper, whether she's a millennial or a baby boomer.

Meeting customer needs related to sustainability and naturals is not new at P&G. Take laundry as an example. P&G was the first multinational company to remove phosphates from all laundry detergents without a compromise in cleaning. In 2005, we introduced Tide Coldwater to promote energy efficiency with a specifically formulated detergent that help consumers reduce energy usage by up to 50% per load, while delivering against the superior performance expectations of Tide.

In 2011, we launched the ultimate detergent sustainability offering super concentrated single-unit dose. Before the Tide PODS' launch, this segment made up 2% of the laundry category and now represents over 15% of the laundry market and accounts for 90% of laundry category growth. We're currently launching the three-chamber unit dose product in both Japan and China.

Two years ago, we introduced the first bio-based detergent with the cleaning power of Tide and Tide purclean, with 65% bio-based ingredients produced with 100% renewable wind power electricity, in a facility operating with zero manufacturing waste to landfill. Today, Tide purclean is growing over 50%, 4 times faster than the Naturals detergent segment. This year, we expanded our bio-based offerings across the detergent portfolio to include Gain Botanicals and Dreft purtouch.

We're doing the same in other categories. In late September, we launched Whisper pure cotton in China, our new premium pad with 100% natural cotton top sheet. Results are strong with sales double that of going-in expectations. We've launched additional Feminine Care natural test and learn offerings across key markets.

In Baby Care, we're entering the natural segment with an offering that will include diapers and wipes. Today, this segment represents over 5% of category dollars and is growing double-digits. Early testing of the offerings show a preference versus other leading natural products and broad consumer appeal.

In Beauty, we launched Herbal bio:renew last year, made with a blend of antioxidants, aloe and sea kelp and free of parabens, dyes and gluten. We launched Rejoice Micellar water in China, a non-silicon shampoo and conditioner. This month, we're launching Pantene Micellar to bring the same benefits of a gentle cleansing shampoo and conditioner that removes impurities with no silicones, parabens or dyes.

We've also announced the acquisition of the Native natural deodorant lineup to broaden our antiperspirant and deodorants portfolio in the naturals segment. We're making packaging more sustainable with projects that expand our use of post-consumer recycled plastics. One of our first applications is using reclaimed beach plastic for Head & Shoulders bottles. As supply of these materials grows, we'll look to expand their use to other categories.

In Health Care, we're launching ZzzQuil PURE ZZZS a melatonin-based sleep aid, naturally free of artificial flavors, gluten, lactose and gelatin.

Our supply network transformation further enables improvements in environmental sustainability as we move manufacturing and distribution closer to consumption. Since 2010, we've reduced truck transportation kilometers by more than 25%. Over the same time period, our plant sites have reduced water usage by 24% and increased our use of renewable energy to 10% with a goal of 30% in the next four years.

As we reported on our most recent Citizenship Report published in November, we recently achieved our 2020 goal of reducing energy consumption at P&G facilities by 20%, four years ahead of schedule. And recently, we set a goal for zero manufacturing waste to landfill from all production sites by 2020.

Annual sales of P&G naturals and significantly more environmentally sustainable products like Tide and Gain unit-dosed detergents and Tide Coldwater are well over $1 billion, with many additional products just launching and more in the innovation pipeline.

Innovation drives superiority and builds brand relevance across age groups including millennials. Over the past year, 13 of our leading brands were market share leaders among millennial consumers including Always, Bounty, Cascade, Charmin Crest, Dawn, Bounty, Downy, Gillette, Olay, Old Spice, Swiffer, Tampax, and Tide. Millennials do a lot of their shopping online. Last year, P&G sales in e-commerce exceeded $3 billion. The goal this year is to build e-commerce sales to nearly $4.5 billion. Fiscal year-to-date, our e-commerce sales growth is up nearly 40%, with all of our top markets and 8 out of 10 product categories growing or holding market share.

We're making good progress but we're not yet where we need to be in all categories and markets. Mainline taped diapers in China are a challenge. We've made tough choices to improve our position in Grooming. We face highly capable competitors who continue to innovate their products and business models.

Addressing these challenges and extending our product package demand creation superiority will continue to require investment, which underscores the importance of productivity. We'll continue to drive productivity improvements to lower cost and generate cash. As you know, we completed a $10 billion productivity program in fiscal 2016 and have doubled down another $10 billion starting next fiscal year.

We continue to progress our supply chain transformation. Next month, we expect to start production of the first of several categories at our new state-of-the-art multi-category manufacturing facility in West Virginia. The sustainability efforts I recited earlier obviously go hand in glove with our productivity efforts contributing significantly to reductions in costs.

We've been talking a lot about media transparency, which has been improving. As this improves, it's clear and clear to us that there's more opportunity to eliminate waste by reducing excess frequency within and across channels, eliminating non-viewable ads and stopping ads served to bots or adjacent to inappropriate content. Through these efforts, we've been able to eliminate waste and cut losses while simultaneously increasing reach the number of consumers we're actually connecting with by about 10%. Looking ahead, we see further cost reduction opportunity through more private market placed deals with media companies and precision media buying fueled by data and digital technology.

We continue to reinvent our agency relationships, consolidating and upgrading P&G's agency capabilities to deliver the best brand-building creativity. We've already reduced the number of agencies nearly 60% from 6,000 to 2,500, saved $750 million in agency and production costs, and improved cash flow by over $400 million additional through 75-day payment terms.

In the next phase, we're targeting to save another 400 million, reducing the number of agencies by another 50% and implementing new advertising and media and agency models. We need the contribution of creative talent and are prepared to pay for that. We don't need some of the other components of the cost.

We'll move to more fixed-and-flow arrangements with more open sourcing of creative talent and production capability, driving greater local relevance, speed and quality at lower costs. We'll automate more media planning, buying and distribution, bringing more of it in-house.

We're focused not just on cost productivity but also 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 for P&G, has yielded over $4 billion in cash in the four years we've been driving them.

Productivity improvements have been critical to offsetting the headwinds from foreign exchange and to increase in our industry-leading margins. Our aggregate 22% core operating profit margin is the third highest in the industry. We hold further advantages and below-the-line costs. We borrow at some of the most favorable rates in the industry and we have a tax rate that is among the industry's lowest, leaving us with the second highest after tax profit margin in the industry with 3.5 out of five years of the next productivity programs still ahead of us. Productivity improvement will be critical to fund investments for sales and market share growth while continuing to expand profit margins.

Alongside all the other work, we continue to evolve our organization structure and culture. We're now about six months into the implementation of the end-to-end and freedom within a framework organization models, simplifying the structure and clarifying responsibility and accountability.

We're managing careers to increase mastery and supplementing our internal talent development system with skilled, experienced external hiring. We strengthened our compensation and incentive programs. We're increasing the granularity of bonus awards trying to put them much closer to the results individuals deliver.

Based in part on shareholder input, the board's compensation and leadership 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. David will talk more about each of these areas, superiority, productivity, organization and culture, when we're together in a few weeks at CAGNY.

Let me move now to guidance for fiscal 2018. We are maintaining the organic sales growth guidance range of 2% to 3% which will require further top line acceleration on the back half of the year in a highly competitive and dynamic marketplace. We expect fiscal 2018 all-in sales growth of around 3%. This includes a modest net benefit from the combination of foreign exchange and acquisitions and divestitures.

We're raising the top end of our core earnings per share guidance range, shifting from a range of 5% to 7% to a range of 5% to 8%. We're raising the upper end of the range by 1 point to reflect the benefit from the Tax Act which I outlined earlier.

It's not entirely clear what competitive dynamics are going to be in response to the Act. We're maintaining the bottom end of the range to reflect that uncertainty that still exist around these dynamics in our categories. We now expect the core effective tax rate on the year to be in the range of 22.5% to 23%. Looking further forward, we expect ongoing core effective tax rate in the range of 21% to 22%, starting in fiscal 2019.

As I've indicated earlier, the changes included in the 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 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 calculations for earnings and exchange rates for our foreign subsidiaries.

Now, as you think about top line for the remaining two quarters, please remember that Gillette price reductions won't anniversary until Q4. We're also facing several additional near-term top line pressures including the Algerian ban on finished product imports that I mentioned, recent VAT increase and reduced subsidies for energy and utilities in Saudi Arabia, one of our top 15 markets, which will pressure near-term consumption as we've clearly seen in the month of January.

As you think about earnings per share for the remaining two quarters, there will be little to no impact – little to no benefit from tax reform. The benefit from the phased-in tax rate will be offset by lost credits and deductions in higher interest and operating expenses. On a before-tax basis, we expect much stronger earnings growth in Q4 than in Q3. Recall that the third quarter base period benefited from several non-recurring gains including the sale of an office building in Mexico and transition services income from the Beauty divestiture.

We plan to deliver another year of 90% or better adjusted free cash flow productivity. This includes CapEx in the range of 5% to 5.5% of sales. We will continue our strong track record of cash return to shareholders. We expect to pay nearly $7.5 billion in dividends this year. We're increasing our fiscal 2018 share repurchase outlook from a range of $4 billion to $7 billion to a range of $6 billion to $8 billion, reflecting strong operating cash flow, continued working capital progress, and the cash benefit enabled by the Tax Act. Combined, we will return between $13.5 billion and $15.5 billion of value to shareowners this fiscal following $22 billion last year.

Our efforts to focus on strengthening our portfolio to extend our margin of competitive superiority, to transform our supply chain, to enhance our industry-leading margins, to simplify our organization structure and increase accountability are all aimed at delivering balanced top and bottom line growth that creates value over the short, mid, and long-term.

Our results for the second quarter were in line with our expectations and keep us on track for the fiscal year. As I just mentioned, we're maintaining top line guidance, reflecting the help from the Tax Act and the guidance range on the bottom line and our increase in our share repurchase assumptions.

With that, I'd now be happy to take questions.

Q&A

Operator

Thank you, sir. Your first question comes from the line of a Wendy Nicholson with Citi.

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

Hi. Good morning. Could you address the Baby Care business specifically? The weakness there surprised me because at least in tracked channels your market shares actually look pretty good. So I'm wondering, number one, was the weakness more international? Specifically, can you talk about how the Diaper launch is doing in China and what your plans are specifically in Baby Care to get volume growth growing again? Thank you.

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

Sure, Wendy. Let me start with China. Our plans there, behind the new initiatives, are largely on track. We built share during the quarter in the premium segment of the taped form. And we continue to do very well both in the premium priced tier and in the mid-priced tiers with the Pants business. We've grown from the number five player on Pants to the number one player on Pants, which is by far the fastest-growing form in the category. As you know, in China, we had a large mid-tier business, and that business is declining versus year-ago.

We've taken some actions recently to adjust the rate of that decline, but we've made some specific choices in terms of putting our priority in those premium segments and in the Pants segment, which are going to grow faster over the long-term and are more profitable.

In the U.S., as we've talked before, which is obviously the largest market for us in diapers, along with China, there continues to be significant retail competition which is forcing prices down to consumers. While that doesn't change the price that we necessarily sell products through to these retail channels, it starts driving price points in the marketplace lower, which affects businesses like Luvs. So Luvs has much more competition than it has historically had. And that's been coupled as well by strong price points on the behalf of branded competitors. So we've made some changes in our Luvs pricing as well to respond to those realities.

We have a pretty exciting second half in terms of innovation in Baby Care. I talked during the call about the Pampers pure launch, which we're very excited about. And we're continuing to drive innovation in the Pants segment across the world. So work still to do.

I think the China dynamic will remain with us for some time. We'll continue to grow faster at the top end in the Pants. Over time, the offset in mid-tier, particularly with some of the actions we've taken, will diminish. We hope to be growing that business by the end of the fiscal year. And, clearly, we hope to be growing Pampers on a global basis as we complete the year.

Operator

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

Q - Olivia Tong {BIO 7481692 <GO>}

Good morning. Thanks. With respect to the tax benefit, in the past, you said you aren't suffering from the lack of ideas. So I'm a bit surprised that you're increasing the share repurchase plan. So as you think about it, what's sort of the plan longer term for some of the benefits that you get from a lower tax rate? Because as I think about where you could potentially put that, I mean price actually turned negative for the first time in a while, so you're not under-investing in price. And then also within that, I'm just curious where M&A potentially fits in as well? Thank you.

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

Thanks, Olivia. We've been very clear about our intention to invest in superiority across the five touch points, which we've talked earlier today. That's primarily going to be focused on product, package, communication, and in-store. But where we need to sharpen value equations, either at the consumer or the retail level, that could also be a target for investment. We intend to continue to keep the bottom line growing and to be growing margins through productivity, which will both provide the fuel for reinvestment and for margin improvement.

We really, as I've talked about many, many times before, don't view pricing and promotion as high on the list in terms of our options to grow the business. We'll do it when we need to do it, but there's nothing proprietary in promotion, there's nothing proprietary in price. We would much rather invest in items where we can derive proprietary benefit over long periods of time.

You mentioned the price impact on the quarter. We've held or grown price, inclusive of promotion, for 28 consecutive quarters until the one we just completed and for 13 consecutive years. So the preponderance of the evidence in terms of our intentionality around pricing remains.

Most of the impact in the quarter we just completed was Gillette which, as you know, anniversaries itself in April. And then I talked as well in the answer to Wendy's question about the pricing that we've taken on Luvs. But generally, we're going to be continuing to invest in the business, driving superiority, driving sustainable competitive advantage, doing it in a responsible way, driving margin simultaneously.

Operator

The next question comes from the line of Bill Chappell with SunTrust.

Q - William B. Chappell {BIO 1737315 <GO>}

Thanks. Good morning. Hey, Jon, going back, could you just talk a little bit more about the impact in the quarter on growth? I think you talked about a retail de-stocking in Algeria. Just maybe a little more color on those two issues. Would they have any impact as we move into 3Q or 4Q? And do you see any other, especially on the inventory de-stock, affecting 3Q or 4Q?

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

Sure. So the first thing we mentioned was the pricing impact for Gillette which, as you know, will roll off in Q4; and that was 30 basis points of impact within the quarter. It'll still be with us next quarter, but then will anniversary itself.

The second thing we talked was 40 basis points impact of U.S. retail inventory reductions. And I, obviously, won't get into specific customers. But in one of our large customers, for example, sell-through, in other words sale of their products in P&G brands, was up 1% in the month of December. Sales to that customer were down or 3.5%. So you see a significant contraction in inventory that's happening there, and we're seeing that fairly broadly across the board.

We expect that will continue into the next quarter because most of the retailers' fiscal year ends are in January. Well, I wouldn't expect that trend to disappear. It's largely a one-time item and shouldn't be affecting us to that level of magnitude going forward. So there should be some pickup there.

The Algerian situation isn't a retail inventory situation; it's a government regulation situation where they have forbidden the import of finished product in our categories and most of our business in Algeria is supplied through import. We expect that situation – we're obviously working many alternatives and working very productively with the authorities but we expect that to continue to be a constraint in the third quarter.

Operator

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

Q - Steve Powers {BIO 20734688 <GO>}

Great. Thanks. Good morning. Jon, I was hoping you could just unpack the negative margin mix a bit more in the quarter with China presumably better; skincare SK-II better; Baby, worse, I'd expected margins to be a bit better, Grooming declines notwithstanding. So, could you just I guess elaborate where the incremental mix headwinds are coming from perhaps as it relates to the U.S. inventory reductions? But I'm just really trying to understand how mix is likely to evolve over the balance of the year. And I guess above and beyond that whether what you've called out as negative mix is maybe better described as another form of reinvestment above and beyond the pricing adjustments and the investment in innovation that you've mentioned. So just I guess, in a nutshell, where's the negative mix coming from and how's it likely to evolve from here? Thanks.

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

Sure, Steve. The simplest way to think about is at the level of geographic mix. We delivered over 2% organic sales growth on the quarter. The U.S. was about 1%, slightly over 1% with the balance, obviously, growing faster than that. And as you know, our margins in the U.S. are much higher than the balance.

We expect – the prior question, I talked about most of those headwinds being U.S.-centric, i.e., Gillette pricing and the retail inventory reductions, so we would expect absent any other changes to accelerate our growth rate in the U.S. in the back half, which should mitigate – may not eliminate, but mitigate the margin difference.

Remember, historically, whenever we've been in a position where the balance of the world is growing at a faster rate than the U.S., there typically is a negative – some element of negative margin mix. Now, we're working hard, obviously, from a productivity standpoint and pricing where it's appropriate behind more superior offerings, clearly doing that in China to mitigate that impact going forward. But in large part, it was, for the quarter, geographic mix.

Operator

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

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

I was hoping you could talk a little bit about the Gillette innovation. I was surprised there was kind of no mention of it. So, a lot of new products sort of unprecedented coming to market, if you could talk a little bit about retailer support, marketing plans, when we should start to see that, in particular in terms of retailer, anyone that's particularly getting behind it and what we should be watching for? Thanks.

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

So, first of all, let me just talk about the business in total in the U.S. in Grooming, and generally, the intervention plan that we've put in place is working very well. We grew volume for the third straight quarter on the U.S. Male Shave Care business. The quarter we just completed, volume was up 6%. For the category with male shave, up 8%, and the volume share trends are also improving with share growing 0.6 points in the last quarter. We've just brought the new items to market and are beginning the commercialization activities behind them. Retailer uptake on those items has been encouraging, but really nothing to report from an off-take standpoint yet.

Operator

Next, we'll go to Ali Dibadj with Bernstein.

Q - Ali Dibadj {BIO 15328592 <GO>}

Hey, guys. So I wanted to go back to pricing again, and I totally appreciate and get and see the 28 quarters of flat to positive pricing. But the pricing trend has clearly been a little bit downwards and, arguably, you've been pricing below your combined kind of market inflation rates for years now. And then of course, this quarter is a negative price while commodities are going up. And so, this kind of pricing down as commodity's up, to be fair, isn't inconsistent with what we're seeing from your competitors either, right? So, I'm not blaming you, just to be clear, at least not this time. CPG pricing not keeping up with inflation seems to be kind of a trend now.

So, I'm trying to get a better sense of, from an industry perspective, as you guys see it, what's driving that? I mean is it the retailers, especially in the U.S. really pushing back? Is it the consumer's saying, gosh, these are commoditized? Is it fragmentation or commoditization, it's going to be a combination of those, but if you can elaborate?

And do you kind of think that's the new world we're living in here. That's the new reality for CPG, that investors should be concerned about pricing power much less than it was before? Or do you think this is a transition and we're just going to get through this and everything's going to be fine later on? So, thank you for that.

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

Sure. There's a lot within that. Let me go piece by piece. As relates to the relationship between pricing and commodities, well, commodity costs are increasing and they're clearly affecting both our gross margin and our bottom line, as we outlined. They have not increased to the point where, typically, pricing can be taken and held. We're still at a point where if we were to reflect the commodity cost and pricing, they would result in price increases, it would be relatively modest and that typically wouldn't either A, be followed; or b, be passed through on shelf. So, that's part of the dynamic that you're seeing there, and I would assume that's true for other companies, but I won't comment on that.

In general, slow market growth which we currently face also leads to more competitive behavior in terms of pricing. And that's why in many ways, we've chosen to focus our portfolio where we have which is in categories where performance drives brand choice and why we're doubling down on advantage within those categories to ensure that, that performance advantage is clear and noticeable to consumers.

We see in many parts of the world including the U.S. including in China, significant growth still at the high end of the market. In many categories, more growth at the high end than in the low end. So, I think you're absolutely right to point to this as a pain point kind of in the immediate present. I think our strategy is designed to find the best path to a better place, which is higher category growth driven by products that deliver higher benefit for consumers. And I don't see pricing as having gone through a sea shift that should reflect your view on the industry long-term.

Operator

Your next question comes from the line of Dara Mohsenian with Morgan Stanley.

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

Hey. Good morning. So, Jon, if you look at divisional profit ex corporate expense it was flat year-over-year in Q2 after a decline in Q1. As you just talked about, pricing was negative in the quarter for the first time in more than seven years despite the commodity pressure.

As you look going forward, you guys have spent a lot of time, money, and effort in turning around market share and driving improved performance there. Is there any shift going forward in terms of how you drive profit growth? Any strategy tweaks in terms of accelerating cost cutting, taking greater pricing, et cetera? How should we think about sort of the balance between market share focus and profit growth going forward?

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

We believe, as you know, in a balanced approach. We think it's the only way to sustainably build value in this industry over periods of time. We need to be growing our top line, both our markets and our market shares. At the same time, we need to be growing margin.

The strategic initiatives and focus areas that I talked about earlier, both productivity and the doubling down on competitive advantage and superiority, both work in our favor in that regard going forward. So, everything that we're doing, as I mentioned in the prepared remarks, is designed to drive both in a balanced way.

We have more work to do, as your question obviously points out. I mentioned, for example, going even much further in the area of advertising, strengthening our programs, increasing reach but really making a serious effort to eliminate costs that just aren't serving anybody's purpose in that space. We're doing that across the income statement, across the balance sheet, but it continues to be a very significant focus.

Operator

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

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

Thank you. Good morning. I have a question on your market share, Jon. It does sound like broadly your market share losses continue to persist. So, could you update us on your thoughts as to when you expect to stabilize your shares and then ultimately to increase them? Is it realistic to expect to see this by the end of FY 2018?

And then you did talk a lot about continued investments. So, it does seem like you need to increase investments in R&D and in advertising to begin to gain market share. And just if that is, in fact, true, could you just give us a sense to the expected increases for both? Thank you.

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

We did increase advertising in the quarter, to be clear. We're up about 2%. I continue to expect that we're going to be investing in both R&D and advertising. We're obviously just constructing our plans for next fiscal year, so, I don't really have any specifics to share with you there. But its part and parcel of, again, the very focused strategy on daily-use categories where performance solves – drives brand choice and products solve problems. We want to be in a superior position both from a communication standpoint and from a product efficacy standpoint in each of those. And as I've indicated, I do believe that our productivity efforts give us the ability to do just that while simultaneously building margins.

In terms of market share, we expect to be growing – if you just look at the guidance, we've delivered, call it, 1.5% organic sales growth to-date. To get to the 2% to 3% guidance range for the year requires acceleration in the back half. Our markets are growing about 2.5% on average so we would expect to get there in the back half of the year.

Obviously, though, what you're going to see, which we're painfully aware of, may look something, somewhat different than that, not in terms of aggregate results but in the tracked channel numbers simply because there's so much more growth occurring in the non-track channels where we're building disproportionate share. But of course, our objective is to hold and build share in all channels.

Operator

And next question comes from the line of Kevin Grundy with Jefferies.

Q - Kevin Grundy {BIO 16423871 <GO>}

Thanks. Good morning, Jon. I wanted to pick up on the last question with respect to category growth, which it sounds like you still expect 2.5%. So, that's unchanged from the prior call. Can you talk a little bit about emerging markets broadly? It sounds like some of your competitors are talking about – perhaps, we found a bottom here, if not some slight improvement, but that doesn't sound like your expectation. So, maybe you can talk a little bit about that.

And then just secondarily, do you expect any benefit from a consumer perspective with respect to individual tax rates moving lower and given the company's premium SKUs? So, any commentary there would be helpful. Thanks.

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

Sure. If you look at developing market category growth, in the last quarter it was around 5.5%; and that's up a little bit. We saw it increase, an uptick in December. We saw the same thing in developed markets. So I'm hopeful, though I don't have any kind of a crystal ball here in front of me, that maybe we have seen the nadir in terms of market growth rates. With the growth of the global economy pretty much everywhere, which of course can come unhinged at any moment, that also bodes well. But we're basically forecasting market growth in line with most recent history, i.e., the last couple quarters, and we'll be beneficiaries if it comes in better than that.

But I don't get too excited, obviously, over a move in one month, i.e., the month of December. But if you had to state the future on that one month, it is a slightly better picture than the case previously. Obviously, to the extent that disposable income increases as a result of the Tax Act for some consumers, we would hope that that plays through into higher consumption. And we do think that there's a chance we could disproportionately benefit from that given, as you rightly point out, that many of our products do require slightly higher outlay.

Operator

Your next question comes from the line of Jonathan Feeney with Consumer Edge Research.

Q - Jonathan Feeney {BIO 2268157 <GO>}

Good morning. Thanks very much. It's with great trepidation that I say I'm following up on Ali's question, but I will. Going after pricing a little bit, when I look at your strategy, it seems to be kind of somewhat of a counterpoint to a strategy that's prevalent in food and particularly 3G and Kraft Heinz, which has been this whole wave and in other areas are staples too. You could look at Anheuser-Busch taking price at the expense of volume, segmenting the market, reaching more for premium consumers and trying to get people to pay more, and there's a lot in there, there's relationship with the retailers.

Why I ask right now is this segmentation, which it appears to be in U.S. Grooming, seems to set you up to do something like that in that particular category. And I'm wondering if that's a fair interpretation where you can now maybe price a little bit better, reach and try to grab more of that value to consumers presumably you're bringing a lot more value to.

And are there other pockets of your maybe portfolio where a similar strategy is warranted? Or maybe I'm even off-base in interpreting that way. Any comments you have would be helpful along those lines. Thank you.

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

I don't think you're at all off-base. And again, our strategy, which focuses on building advantage, should allow us to do exactly what you described; and you see that playing out through many parts of the product portfolio. If you just look at some of the examples we talked about earlier, whether that's Tide PODS or scent beads or dryer sheets, those are all premium offerings on a price-per-use basis.

The same is true with the item that we're dramatically changing the category growth rate within Adult Incontinence, which is this new Boutique underwear. I mean, that's a clear move to further capture more value in the category. So the strategy sets us up very well to do exactly what you described. We need to do it in an intelligent way, we need to do it in a way which builds value for shareholders, the combination of price and performance, and we'll continue to get at that.

I mean, you don't build price for 28 consecutive quarters and then walk away from it. That's not where we're headed here. But there will be times when, again in response to other moves that have been made, we need to maintain our competitiveness in the market. And we're just not going to accept significant share loss from not doing that.

Operator

Next, we'll go to Andrea Teixeira with JPMorgan.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

Hi. Good morning. Jon, I just want to go back to exactly this question, and just to balance the top line growth and margins. And can you please comment on the additional cash investments on that line on pricing and price mix?

From your new EPS guidance, and that now includes a much lower tax rate, it seems that you became more conservative on how the cost saves will flow into the bottom line, especially on the core operating margin perspective, as you take out, obviously, as you decompose your guidance? Is that a reflection of this competitive environment in U.S. Baby and the de-stocking from retailer that you just mentioned? Or EM is taking longer to show results despite the pickup in Beauty?

So just when I think about strategically, as you step back and you're going to invest more in prices in other categories to recover share besides what you did for Grooming and Luvs? So wanted to kind of elaborate more on that. Thank you.

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

First of all, any Tax Act related impact is future-focused. It's only effective as of January 1, and we're sitting here today talking about results through December 31. If you just think about where we've taken our guidance as a result of the tax change, we took it from 5% to 7%, to 5% to 8%. So there's no change in terms of the inherent amount of reinvestment that's planned. All we've changed in our guidance number is to reflect the fact that there's a lower tax rate.

Our strategy has not changed in terms of how we intend to compete, how we want to be building markets, not diluting markets. Nothing there has changed. Broadly, the competitive environment is not significantly changed. I mean, for example, just look at private label as a metric as to whether there's a big trade-down that's occurring within the consumer set. Private label the last three years in Europe has been flat as a pancake. That's the largest private label market in the world. There are categories where it increases from time to time, but generally we're not seeing a reason to chase lower prices as a result of private label.

In North America, over those three-year periods, private label is up 0.2 share points. It's up in three categories currently; and in two of those categories, we're building share. So I do not expect at all a change in our focus and strategy to deliver value-accretive offerings which drive market growth and our market share disproportionately as part of that all while increasing margins.

Operator

Your next question comes from the line of Joe Altobello with Raymond James.

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

Hey, guys. Good morning. Just a couple of quick ones. I guess, first, on China, I'm not sure Jon, if you gave us a growth number for this quarter. I think last quarter it was up 8%, but that had about 2 points of pull-forward ahead of the Singles' Day. And then secondly, in Beauty, clearly a standout this quarter, how sustainable is the positive mix benefit you're seeing in the Beauty segment? Thanks.

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

So, China, you rightly pointed out, it was up 8% last quarter. It was up 6% in the quarter that we just completed. And some really strong – so well on track for our mid-single digits estimate for the year, some really strong progress in parts of the Beauty business, some really strong progress in Grooming, strong progress in laundry. Feminine Care was up double digits. So, overall, very, very good.

In terms of the positive mix – or let me take your question a different way, do we think that SK-II growth is sustainable? Certainly at attractive levels, yes. More importantly, the balance of the Beauty business continues to be very healthy. I mentioned Olay growth – or may not, but Olay grew 3% in China for the quarter. Overall, global skincare growth was up, every part of our Beauty business was up versus year-ago. Hair Care was up 3%, as an example, with all brands up with one exception, which was Vidal. So, very broad progress in Beauty across geographies. So, I think that is sustainable.

The main inflection point going forward is to address a couple of the items that we've talked about on this call that you've asked about, which are Grooming and that's a big help from an index standpoint there just ahead of us and to address some of the issues in Baby Care which we'll be very proactive about.

Operator

And your final question comes from Jon Andersen with William Blair.

Q - Jon R. Andersen {BIO 15033263 <GO>}

Hey. Good morning. Thank you for the question. I think you indicated earlier that you're building share disproportionately in non-tracked channels and wondering one, did I interpret that right, is that accurate?

And then if so, what have you been able – how have you been be able to kind of accomplish that? I mean, what is it about the way you're positioning your brands, the investments you're making in non-tracked channels or the consumer within those channels that's kind of enabling you to do that? And I know there's an online component and there may be some other non-tracked channels that are large that you're having success in. Thanks.

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

The first is relates to e-commerce, we're building share broadly across our large markets in e-commerce and we built share in 8 out of 10 categories in the last quarter. So, that continues to grow disproportionately. I mentioned I think in the prepared remarks, for example, Olay growing 80% in e-commerce in China for the quarter.

More broadly, as we talk about non-tracked channels, and we've talked about some of this before, if you look at – let's just take the U.S. as an example. What's really happening from a retail standpoint, or one could argue is happening from a retail standpoint, is that shopping is moving to more limited assortment channels. So, the club channel is growing very quickly, the discounter channel, small-format stores and online, which we would argue is a very limited assortment shopping experience.

There's obviously a broad array of assortment that's available but the amount of that assortment that's actually accessed and considered in a typical e-commerce shopping trip is extraordinarily low. And generally, we do well in low assortment environments. If you're going to carry a low assortment or if your shopper is going to expose themselves to a relatively limited assortment, you want it to be that assortment which drives your business as a retailer, and that tends to be leading brands. So, you see in e-commerce a disproportionate appearance in the first and second page of a search for leading brands in many of our categories.

You see in discount channels a willingness to carry branded products in some categories but typically, only one or two brands or the market leader. So, I would expect – and that doesn't mean that we have any inherent right to win in those channels, we need to be very, very competitive and focused in doing that whenever consumers wanted to shop. But those dynamics have tended to work in our favor and I would expect would continue going forward.

Q - Jon R. Andersen {BIO 15033263 <GO>}

Thanks. That's helpful.

Operator

Ladies and gentlemen, that does conclude today's conference. Thank you for your participation. You may now disconnect. Have a great day.
