Colgate-Palmolive Company (CL) CEO Noel Wallace on Q3 2019 Results - Earnings Call Transcript

Nov. 1, 2019 4:31 PM ET | 1 Like
by: SA Transcripts

Q3: 11-01-19 Earnings Summary

Press Release

EPS of $0.71 beats by $0.01 | Revenue of $3.93B (2.16% Y/Y) misses by $-18.14M

Earning Call Audio

Subscribers Only

00:00 -44:34

Colgate-Palmolive Company (NYSE:CL) Q3 2019 Results Earnings Conference Call
November 1, 2019 11:00 AM ET

Company Participants

John Faucher - Senior Vice President of Investor Relations

Noel Wallace - President and Chief Executive Officer

Henning Jakobsen - Chief Financial Officer

Conference Call Participants

Steve Strycula - UBS

Lauren Lieberman - Barclays

Steve Powers - Deutsche Bank

Jason English - Goldman Sachs

Wendy Nicholson - Citigroup

Robert Ottenstein - Evercore ISI

Ali Dibadj - Sanford C. Bernstein

Olivia Tong - Bank of America

Kevin Grundy - Jefferies

Bill Chappell - SunTrust

Andrea Teixeira - JP Morgan

Mark Astrachan - Stifel

Operator

Good day, and welcome to today's Colgate-Palmolive Company Third Quarter 2019 Earnings Conference Call. This call is being recorded, and is being simulcast live at www.colgatepalmolive.com.

Now for opening remarks, I would like to turn the call over to the Senior Vice President of Investor Relations, John Faucher. Please go ahead, John.

John Faucher

Thanks, Paula. Good Morning, and welcome to our third quarter earnings release conference call. This is John Faucher, Senior Vice President for Investor Relations.

Today's conference call will include forward-looking statements. Actual results could differ materially from these statements. Please refer to the earnings press release and our most recent filings with the SEC, including our 2018 Annual Report on Form 10-K and subsequent SEC filings, all available on Colgate's website for a discussion of the factors that could cause actual results to differ materially from these statements.

This conference call will also include a discussion of non-GAAP financial measures, including those identified in tables 8 and 9 of the earnings press release. A full reconciliation to the corresponding GAAP financial measures is included in the earnings press release and is available on Colgate's website.

Joining me this morning are Noel Wallace, President and Chief Executive Officer; and Henning Jakobsen, Chief Financial Officer. I will begin with some thoughts on our performance before discussing our updated 2019 guidance. We'll then open it up for Noel's Q&A session.

The third quarter marked a further step in our plan to return to sustainable organic sales growth. Throughout 2019, we are focused on innovating around the core of our business, driving growth in adjacent segments and expanding our availability in faster growth markets and channels. Along with higher levels of consumer-facing spending, these strategies are paying off in broad-based growth across our businesses.

Q3 marked the third quarter in a row where we delivered a combination of both volume and pricing growth on an organic basis. Volume was up in every division, and pricing was positive in every division, except for one. Our revenue growth management strategies are driving pricing growth as we focus on premium innovation.

On a geographic basis, we saw organic sales growth in five of our six divisions. Importantly, we returned to organic sales growth in Asia Pacific, including delivering organic sales growth in the Greater China region. We drove a good combination of developed market growth, plus 3.5%; and emerging market growth, plus 6%. And from a category standpoint, we again delivered organic sales growth across all four of our businesses: Oral Care, Personal Care, Home Care and Pet Nutrition.

In order to drive this growth, we continue to invest behind our businesses. Total advertising spending was up nicely in the quarter. In particular, I would point to Hill's where a significant increase in spending over the past few years behind our purpose-driven marketing has been a key driver of the organic sales growth.

We were also pleased to close the Filorga transaction on September 19th, continuing the expansion of our Personal Care portfolio into skin health, although we point out that Filorga's results from the acquisition date through quarter end were immaterial to our results of operations and were not included in our Q3 results.

On the sustainability front, we received recognition from the Dow Jones Worldwide Sustainability Index, taking the lead in our industry sector for the first time. Back in September, Noel discussed our new recyclable toothpaste tube. We are currently in production and it will be on shelf under the Tom's brand in November.

Moving to our Q3 results. Our net sales grew 2% in the quarter. We delivered 4.5% organic sales growth, with 3% unit volume growth and 1.5% favorable pricing. This was partially offset by foreign exchange impact of minus 2.5%. On a GAAP basis, our gross margin was even with Q3 2018. Excluding the impact of our Global Growth and Efficiency Program, it was down 20 basis points year-over-year. Pricing was a positive 70 basis point impact to gross margin in the third quarter, while our productivity programs drove a 240 basis point benefit. This was offset by a 310 basis point drag from raw materials inflation, which included foreign trend -- foreign exchange transaction costs.

Other, primarily mix was unfavorable by 20 basis points. Our stronger growth in emerging markets relative to our developed markets business put some slight pressure on our gross margin. On an absolute basis, advertising investment was up 7% year-over-year.

On a percent of sales basis, advertising was up 50 basis points year-over-year. Excluding charges resulting from our Global Growth and Efficiency Program and advertising spending, our SG&A expenses were up year-over-year in the third quarter on an absolute basis, but down as a percent of sales, as we were able to offset higher compensation and other costs with savings from our productivity programs.

On a GAAP basis, diluted earnings per share of $0.67 were up 12% year-over-year in Q3. Excluding charges resulting from our Global Growth and Efficiency Program in 2019 and 2018, acquisition costs in 2019 and a charge related to U.S. tax reform in 2018, diluted earnings per share were down 1.5% to $0.71. Our free cash flow through the first nine months of 2019 was $1.9 billion, which was up 3% versus prior year.

Taking a quick look at the divisions. North America net sales grew 1.5% in the quarter, driven by 1% pricing growth and 0.5% volume growth. There was no FX impact in the quarter. Our performance in e-commerce where we continue to see strong share growth and other non-measured channels, was partially offset by declines in food retail. We also remain very pleased with the performance of our skin health businesses, Elta MD and PCA Skin. Our focus in North America continues to be on the premiumization of our Oral Care portfolio through innovation.

Colgate Total SF and Colgate Optic White drove pricing growth in the quarter, and we have further innovation to come in the next few quarters, particularly on Optic White. Europe posted a 5% decline in net sales, with organic sales flat and foreign exchange minus 5%. Growth in Northern Europe behind the relaunch of Colgate Total and our whitening brands, was offset by weakness in Western Europe, where the retail environment continues to be difficult. As with North America, we expect significant premium innovation to drive improved price mix going forward, as we have a full calendar of naturals innovation in the first half of 2020.

Latin America net sales were up 3%, as 4.5% volume and 3.5% pricing were only partially offset by 5% negative foreign exchange. Our 8% organic sales growth was broad-based, as we saw organic sales growth in every hub for the third quarter in a row. While Brazil benefited from the year ago comparison, which included some impact from the trucker strike, the underlying business remains solid and pricing was up nicely, driven by premium products like Protex Face and Colgate Total 12.

Net sales in Asia Pacific were up 2.5%. Volume growth was 2%. Pricing grew 1%, while foreign exchange was minus 0.5%. Organic sales growth of 3% was our first positive result in six quarters. Importantly, we delivered organic sales growth in the Greater China region in the quarter, driven by improvements in both volume and pricing.

While the China improvement in the third quarter was ahead of our expectations, we remain laser-focused on executing our plan to return the business to sustainable profitable growth through improved go-to-market capabilities, China-specific innovation and improved brand marketing. Asia-Pacific growth was led by toothpaste, particularly our naturals portfolio and Colgate anti-cavity toothpaste.

The Africa/Eurasia division delivered 5% net sales growth in the quarter, its best result in several years. Organic sales growth of 6% consisted of 4% pricing growth and 2% organic volume growth. FX was a 2% drag on net sales growth, while our newly established joint venture in Nigeria was a 1% benefit to net sales and volume growth. The organic sales growth in Africa/Eurasia was consistent across all hubs and we are particularly pleased with our strong performance in Eurasia in the quarter where our focus on faster growth channels like discounters is paying off.

Momentum on our pet food business continued in Q3, as Hill's delivered 8.5% net sales growth and 10% organic sales growth. Hill's' 6.5% volume growth was their best results since 2006. Pricing was positive at 3.5%, while foreign exchange was negative at minus 1.5%. Our core innovation strategy continues to deliver robust growth in North America and is now beginning to pay off internationally as we rollout the Science Diet relaunch around the globe.

In August, Hill's partnered on NBCUniversal's annual Clear the Shelters Pet adoption campaign in the U.S. This year's campaign was its most successful ever, with over 160,000 pets adopted over the course of the campaign, an increase of 57% versus last year's program. Hill's earned over 9,000 displays, which helped drive the strong U.S. volume growth in the quarter.

Moving on to guidance. We continue to expect net sales to be flat to up low-single-digits. We have raised our organic sales growth target to plus 3% to 4%, with the full-year growth rate roughly in line with year-to-date growth. We now expect our full-year gross margin to be down slightly on both a GAAP basis and excluding the items referenced in the earnings press release. We do expect gross margin to be up year-over-year on both a GAAP and non-GAAP basis in the fourth quarter. We would expect advertising as a percent of sales for the full year to be fairly consistent with the year-to-date level. We now expect our full-year 2019 tax rate to be between 24% and 24.5%, both on a GAAP basis and excluding the items referenced in the earnings press release.

Our previous guidance was for 25% to 26%. This change includes the recent reduction in corporate taxes in India. As mentioned on the Q2 call, we will moderate our share repurchase activity for the next several quarters in order to return to a leverage ratio more in line with our ratio before the Filorga transaction. Based on current spot rates, we expect the GAAP earnings per share to be down low-single-digits for the year. Excluding the items referenced in the earnings press release, we still expect earnings per share to decline mid-single-digits for the year.

And with that, I'll turn it over to Noel for the Q&A. Paula?

Question-and-Answer Session

Operator

[Operator Instructions]. First, we'll go to Steve Strycula with UBS.

Steve Strycula

So, Noel, question on the gross margin and for John as well. How do we think about what caused the weakness in Q3 in gross margin sequentially from the last quarter and what changes, if anything, to drive the positive inflection in Q4 and into next year? Thank you.

Noel Wallace

Sure. Thanks, Steve. So yes, we're disappointed with the gross margin in the third quarter. A couple things that happened that we weren't expecting. Obviously, the sales mix, as John outlined, with more growth coming with emerging markets had a softening impact on the margin line. This significant growth we saw on the Hill's business, which quite frankly was extraordinary. We're very pleased about that. Obviously, the mix more toward Science Diet versus prescription diet, obviously, compressed the margin a bit. Raw materials were slightly worse than we were expecting as we went into the quarter, as was foreign exchange, slightly worse than we were expecting as we went into the quarter.

So overall, a couple surprises that came through. We're focused on the premiumization. We're focused on accelerating, funding the growth through the back half -- through the fourth quarter, excuse me. And obviously, getting the mix right across the regions and that's where we'll focus our attention going into the fourth quarter. So, we're confident we'll see fourth quarter margins rebound as we finish out the year.

Operator

And next, we'll go to Lauren Lieberman with Barclays.

Lauren Lieberman

Okay. Thank you. I was curious if you could talk a little bit about trends in North America. And I know Nielsen data clearly does not tell the full picture of your Oral Care business. But then seeing the results this quarter, it feels like we're still very much more price-mix heavy than volume heavy. So if you can talk a little bit about how that Total relaunch is progressing? What you're now seeing in terms of repeat, and if it -- maybe a thought that the pricing has gone possibly a little bit too far on that brand? Thanks.

Noel Wallace

Thanks, Lauren. Yeah, let me talk broadly on Colgate Total. Obviously, we're really pleased with the relaunch. Our shares are up on a global basis versus where they were pre-launch. As you know, we took a 10% price increase on that business globally. Particularly as it relates to the U.S., we took a 20% price increase on that business. There has been some elasticity that we've seen come through. Our share is down about three-tenths of a share point versus where we were before we started the relaunch. A little bit disappointing, we expected it to be flat to up. We're in the midst of looking at our messaging and ensure we get that corrected as we continue to accelerate investment behind that business moving forward.

But pleased given the significance of the price increase that were slightly down, but more importantly, we'd like to see that turn around as we get some of the go-to-market and some of the marketing plans more sharp in the balance of the year. But globally, pleased, as I mentioned, the fact that we've gotten a 10% increase and we're growing share is a real progress for us. And we'll continue to put the investment behind that business as we move through the balance of this year and into the first half of next year.

It's consistent with our -- with our strategy to get the core businesses moving and we'll look to relaunch some other core businesses in 2020. We will start to outline that as we move into the first quarter press release. Some of the excitement that we have on some of the innovation coming down that, that will come with more pricing as you would expect and more premiumizations. All-in-all, I think we're pleased with Colgate Total overall.

The U.S. was a bump this quarter for sure. We were expecting a little bit more. It's been a tough promotional environment in the U.S. Other channels, non-tracked channels continue to do well, but not as well as we had in the second quarter, so a bit lumpy in that regard. We're very focused in the U.S., specifically on premium innovation and getting that right as we move into 2020.

Our revenue growth management principles that we're starting to embed across the entire commercial organization, we see the discipline coming behind that. And we're quite optimistic that we'll see gross margins continue to improve as we move through the balance of 2020 and we'll see the shares come back as we start to put the premiumization strategy in place.

Operator

And moving on, we'll go to Steve Powers with Deutsche Bank.

Steve Powers

So tremendous top line performance in pet again this quarter. I guess the question for me is how does that compare to -- how does that compare to your plan coming in and how does it influence your thinking, if at all, going forward? Relatedly, when do you think you might see more of a profit inflection in that business, commensurate with the top-line momentum?

And then if I could tack on a follow-on to Steve's Strycula question at the open. And I hear you on the puts and takes on gross margin in the quarter. But just as a follow-up on that, how might this quarter influence your thinking about realistic gross margin objectives looking into 2020? Because your 2019 represents, I think, the fourth time in about -- fourth time in five years that Colgate has come into the year targeting material gross margin improvement only to finish effectively flattish or down on the year. And I get the macro pressures. But I also see there is a recurring trend. So just how do you protect against being kind of overreaching again in 2020 and having to course correct midyear? Thanks.

Noel Wallace

Thanks, Steve. Let me get -- address Hill's first. Obviously, an extraordinary quarter for the Hill's business. The Science Diet relaunch, which is largely driven by the U.S. right now, we're in the midst of rolling that out through the rest of the world. So, we're quite excited about what that will bring moving forward. But the U.S. had just an exceptional quarter, particularly behind Science Diet. I think everything that we've been talking about in terms of driving the core, increase in the advertising, getting the pricing right on that business, getting the go-to-market and new channel distribution right. In fact, we were up 14% in farm and feed in the quarter and that just is a result of increased focus on some of these emerging channels.

Our e-commerce shares grew eight-tenths of a share point. Our pet specialty share grew eight-tenths of a share point. So, all of this bodes well for sustainable growth moving forward. We see the continued growth in the pet category.

Prescription diet has a significant amount of innovation coming in 2020, and we'll see that continue to play through the business. That obviously plays out in a much higher margin for the business. So the gross margins will improve as we move forward. We were surprised a bit, again, on the gross margin and the raw material increases that we saw on vitamins and other agricultural products in the quarter. The business has taken price increases at the beginning of the quarter, behind both the Science Diet business and the prescription diet business in order to recover that and build gross margins moving forward. So on Hill's, very pleased. It's sustainable. It's broad-based. And we've got the good news coming in terms of international expansion of SD and some good innovation coming on prescription diet. So all bodes well there.

On your margin question, obviously, coming back to the core of our strategy, which is driving the core businesses with price increases in innovation, getting adjacencies right. Obviously, we're very pleased with how the portfolio is shaping up around skin health and the significant margin accretion over the long-term that will bring to our business and the growth that will bring to our business. The adjacent segments that we're going into, particularly around products with natural ingredients, particularly around sensitivity and gum around the world will bode well, channel expansion into pharmacies where we under index.

Likewise, we have significant expansion opportunities in that channel, which will drive improved gross margin moving forward. So listen, we're disappointed. We know our history has been about consistent gross margin improvement. We are laser-focused on delivering the productivity through the P&L to make that happen moving forward. And I think as you see, the top-line continue to grow, which we've been focused on throughout this year. You're going to see the gross margins come behind that as we move through 2020.

Operator

And Jason English with Goldman Sachs has our next question.

Jason English

Hey. Good morning, folks. Thanks for slotting me in. I appreciate it. I'm going to build off of both of those points, real quick on pet. I see your incredibly strong numbers and congrats on that. I also see Nestle strong numbers on its legacy premium brand coming out the U.S. It does beg the question of whether or not we're seeing a broader market movement, pivoting back away from grain-free to some of the products you're offering and Nestle is offerings as well. I'd love it, if you could comment on that, particularly in the wake of the DCM concerns out there?

And then coming back to gross margin real quick. I hear you on the mix components, but I'm nonetheless really surprised when we delve into North America and see 220 basis points of gross margin compression. Despite sort of an easy comp, sequentially your margins eroded a lot more in that market. Inflation pressure stepped up a lot, which seems to defy the broader cost curves we're looking at. And frankly, it leaves me a bit confounded. And I love it, if you could delve deeper there and just to illuminate what's happening there so we can better understand it?

Noel Wallace

Sure. Jason. Let me take the Hill's question first. Obviously, DCM has had an impact. I mean, I think there has been a return particularly to products like ours, which are very science-based and there’s tremendous trust that we built over the years behind our brand.

And as John mentioned, really moving a lot more advertising to our purpose-driven advertising I think has created great credibility and resonates with the consumer and the pet owners. And you've seen that translate into growth.

Obviously, we're very premium priced. The broader market, which is, obviously, you see some of the competitors move into grocery. We think that's also afforded an opportunity for us to continue to differentiate ourselves, which I think talks to more long-term sustainability for that business moving forward. And the innovation pipeline, as I mentioned, is rich and robust. And they're bold on the pricing. So, I expect that business will continue to be -- perform very well for us.

Now specifically on North America margins, obviously, very disappointed with what happened in the quarter. Both volume and pricing was a little below our expectations. Mix worked really against us in the quarter, both from a channel standpoint, from a sizing standpoint and from a category standpoint. So, we had all three moving against us in the quarter and we need to address that.

And the team has put plans in place for the fourth quarter to get that turned around and ensuring as we move into the budget plans for 2020, that we address that. Manufacturing costs, likewise, were a little bit higher. That was the surprise. We're all over that, and we'll address that as we move into 2020. We expect Q4 to be up in North America. There will be some continued headwinds as we get the channels and the sizes are sorted out in terms of where we see the business. But likewise, I think, as we've seen across the total business that we'll see margins improve in the fourth quarter.

The other areas, we're seeing lifts on promotion are not delivering what we expected. Obviously, a slightly more competitive environment with some of the smaller brands in the category. And I think as we continue to accelerate our spending, particularly in digital where we can gain, I believe an advantage, we're going to see that, hopefully, translate back to bigger brands growing faster. So, those are the components. We're on it. We're not pleased at all with it. And likewise, as we go into North America as we continue to accelerate the skin business, that will bode well for margins over the longer term.

Operator

And moving on, we'll go to Wendy Nicholson of Citi.

Wendy Nicholson

Hi. Just following up on that. First, on the skin care business, you've got three acquisitions. It sounds like you're pleased with each of them. It sounds like that each kind of fell a different niche. But can you comment on sort of any further appetite there? Do you feel like you kind of are where you want to be in skin with those three different businesses?

But then my bigger question first, really just a follow-up. My bigger question is, you talked about maybe expanding the sort of relaunch initiative or program like you have with Total and Hill's this year, into some new categories next year. So bottom line, I'm wondering will operating margin go up next year? I care less about gross margin. I care more about how much you plan to spend on marketing? Thank you.

Noel Wallace

Thanks, Wendy. Yes, on your second question, we're not going to guide yet on 2020 as we get into the first quarter. We will give you deep transparency in terms of how we're thinking about margins and operating margins. But overall, if you take where we've been historically, I think you can interpret that we would obviously like to see all those moving in the right direction. Specifically, on the skincare, as you said, we're really pleased. I just returned from a two-week trip around the world meeting with some of the Filorga people, welcoming them into the Colgate family both in Europe and in China.

And I was deeply excited from what I saw from a quality of talent standpoint, from the plans they have in place, from the growth they are delivering and the significant gross margins that they have on those businesses. The plans are solid. They're focused in terms of areas that we believe we can win in and where they believe they can win in on the Filorga business. So, I'm pleased they’re not trying to stretch themselves into different areas. They're very focused on the pharmacy channel. They are very focused on online and obviously building their travel retail business out, which is exciting.

On Elta and PCA, again, terrific growth in the quarter for the business and we're now looking at the 2020 plans in terms of how we want to expand those businesses, which will be exciting. Obviously, the margins allow us to have a lot more flexibility as we move forward and the growth in the category looks terrific. So overall, we're quite pleased with what we have. Never say never, but our focus is to continue to accelerate the growth on those businesses from a top-line and a bottom-line standpoint.

Operator

And next, we'll go to Robert Ottenstein with Evercore ISI.

Robert Ottenstein

Great. Thank you very much. I was wondering if we can return to Oral Care. You mentioned that you were very pleased with the Colgate Total relaunch. I was wondering, first, if you can give us a sense of how much kind of global sales are up for that franchise? And then perhaps go into a little bit more detail globally on how you're doing with therapeutics? How are Elmex and Meridol doing? What markets they've been gaining traction in and maybe how much those are up? And then touch on naturals, particularly in countries that there have been issues and opportunities in China, Russia, and India? Thank you.

Noel Wallace

Yes, we won't comment specifically on the sales numbers. I will tell you that the toothpaste organic growth in the quarter was the highest we've had in six quarters, which is terrific for us. We saw the growth obviously accelerate as we roll Total across Latin America. Mexico and Brazil, our two largest markets, we've had significant success on the rollout of Colgate Total in those markets. Our premium share of the toothpaste segment in both Mexico and Brazil is up.

The shares on Colgate Total in Brazil are up about 1.5, in Mexico about 0.5. So, they look terrific and driving, obviously, more of our business into the premium space. Overall, the shares look good on Colgate Total and we're pleased with what we're seeing. Relative to the second part of your question on pricing, the pricing -- I can't remember what you asked me, Robert?

Robert Ottenstein

On Elmex and Meridol, and then also on the naturals?

Noel Wallace

Thank you. Thank you. Yes, Elmex, as you've heard previously, we launched it in Latin America, specifically in Brazil. That business is doing well. We launched it in the pharmacy channel across both toothpaste, toothbrushes and mouth washes, are seeing great growth on toothpaste, seeing really good growth on toothbrushes. Mouthwash has been a bit soft.

Likewise, we launched in China online. We've generated about a six-tenths of a share point in China on that business, which given the number of brands online, that is a good result for us. And we launched it in the NAMET region, the Northern Africa region. And that continues to do well. The other area was in Turkey with Meridol, which I think we talked about a little bit in the second quarter call how pleased we are with the performance of that business in Turkey that is taking us -- taking the business to market leadership with the success we've had behind both Meridol and Colgate. So overall, we're pleased with that and we're in the midst of thinking about the key markets we'll expand in 2020.

Operator

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

Ali Dibadj

Hey, guys. So, I just have one kind of broad question, taking a step back a little bit. And we see kind of among your peers the kind of the anomaly with a little bit of difficulty -- certainly relative difficulty taking pricing, particularly with such a big innovation rollout with Total and commodities should have been allowing you to take prices. But it was tougher for you than others. Why do you think that is? Is there particularly different category competitive dynamic? For example, Sensodyne's parent company going public in the next couple of years. And I guess related to that, you've in the past have been pretty adamant about saying that you are investing enough and 2019 is kind of one year, reinvestment year rather than a multi-year investment year. Does anything you've seen so far -- again, the category competitive dynamic, ROIs done on the promotional spend, you mentioned a moment ago. Anything at all that gives you pause on the assertion previously that this isn't a multi-year reinvestment phase for Colgate? And I guess, underlying that whether you're going to have to increase reinvestment even further into 2020? Thanks.

Noel Wallace

So, let me take the pricing question first, Ali. We are really pleased with the pricing on a -- we've had -- on a two-year stack, we've had four quarters of sequential growth on pricing, so it looks terrific for us. And I think in an environment that we compete in today, which is certainly very competitive around the world to get that pricing through not only on Colgate Total but across our franchises is terrific. The focus on the core business, bringing real value to consumers into the trade and delivering increased prices through that, we believe is working and that will be the continued strategy moving forward.

Your second point on advertising and investment, listen, we need to continue to investing behind our business and we need to continue to accelerate share growth across the world. We've got a robust pipeline of innovation coming. We're going to continue to support that. We've got big core relaunches coming that we will support. But obviously, getting the gross margin going and continued productivity across the P&L is where we are laser-focused on right now. And that's how we'll construct the P&L for 2020 in terms of how we look at using operating margin, both from a gross margin and the [BO] standpoint to help fund the advertising that we'll need to drive the top-line.

Operator

Moving on, we'll go to Olivia Tong with Bank of America.

Olivia Tong

Great. Thanks. Good morning. First, just on the Optic White innovation North America. I would imagine that that's smaller than the Total relaunch. So, can you talk about other things that you're planning to do in the market to help offset the higher base? And then just a follow-up on the advertising. You've been increasing advertising spend for four consecutive quarters now. Organic growth has been steadily improving. But -- like where or how are you going to improve return on your spend because you have some markets and brands that have really taken off like Hill's and you said you were going to improve in China and you did, but then North American growth has now decelerated. So, is there a need to potentially increase investment even more aggressively from here or what's going to improve the ROI on that? Thank you.

Noel Wallace

Sure. Thanks, Olivia. So on the North America question, they've got a great pipeline behind Optic White in terms of some of the innovation coming, which will include premiumization. As you can imagine that, likewise, we'll be looking at premiumization around the world on Optic White. In fact, we have introduced a 20-pound toothpaste behind Optic White in UK to give you a sense of the boldness of how we're thinking about some of the premiumization strategies.

Likewise, when you take the trend towards natural ingredients in the U.S., you'll see expansions across the Colgate portfolio as obviously a step up on our Tom's of Maine business as well, which we think will be important in terms of driving more premiumization in the North America business and driving more share growth. Relative to pricing and what we need in advertising around the world, listen, let me come back to revenue growth management and how we're trying to embed that across the world, across the commercial organization.

We talked about it a bit. But as I travel, I'm getting more encouraged by the fact that it's taking on deep commercial ownership. So historically, we would take pricing and the directive for that came out of the marketing organization. Now, we're taking our GM across the entire commercial enterprise and holding everyone accountable for delivering pricing opportunities moving forward, not just the marketing folks. So, this is going to be shared responsibility to really go after how we drive ASP, which will ultimately bode well, I think, for the margin. And the spending that we'll need around the world to continue to fund the opportunities that we have.

So, on the advertising and the P&L dynamics for 2020, we will come back to you in the first quarter and give you a lot more clarity on how we're thinking about things. The return on investment, we'll see really coming through as we continue to focus on these big core businesses, which we need to get turned around. And that's where we're going to get the best return on investment, putting a lot more support behind data analytics, particularly in the digital space where we have the ability to really cultivate learning in terms of what's working, what's not. And that will obviously improve our ROI as we move forward.

Operator

And Kevin Grundy with Jefferies, has our next question.

Kevin Grundy

Noel, question on North America and specifically the competitive environment currently and looking forward. So in a context overall, there is a consensus view that industry participants have been relatively rational from a pricing and promotion perspective over the past 12 months with pricing that was put into place in the fall. But as the industry starts to cycle this pricing and with commodity headwinds now less onerous than they have been, it would be great to get your updated thoughts on the promotional environment and specifically the potential for competitive intensity to pick up your, potentially, the detriment of the profit pool. So, any thoughts there would be helpful? Thank you.

Noel Wallace

Yes, I think the environment has been more rational, to be sure, around the world, particularly in North America. I would say the one exception would be Brazil where we've seen some odd pricing in some of the categories, which just doesn't make any sense. But specifically, as it relates to North America, we've seen -- obviously, a lot of our competitors are working together with the trade, everyone is looking to drive category value. And that's what we need to do. We need to ensure that our innovation is premium. We need to ensure that it is driving category dollars and that's where everyone wins in that regard.

We've seen certainly over the last six months to nine months a little bit of pickup in some of the smaller brands, the trade picking up some of those and pushing those. So in the long-term, my view is the big brands, as they get more dialed in on digital, they get more dialed in on how they do data-driven marketing, you'll see opportunities for the big brands to continue to increase the residents and the relatability that we have with consumers. And that's what's key as we compete against some of these smaller brands.

So overall, a rational competitive environment, a little bit more competition from smaller brands. You see a -- the promotional lifts, not as high as they used to be. But I don't see sales on promotion increasing, which is a good news. So, we need to get the innovation right and the premiumization right in North America and we'll be off to the races.

Operator

Moving on, we'll go to Bill Chappell with SunTrust .

Bill Chappell

Just a little bit follow-up on Mexico in particular, but all of LatAm. We've certainly heard from some of your peers and multinationals that there is some slowing there. And so, I guess, maybe what you're seeing for the key market? And then also your ability to -- in line with all the rest of the questions today -- take price as we go into next year with that in mind?

Noel Wallace

Sure. So, let me take the two big markets, Brazil and Mexico. I'll take Brazil first. Brazil, obviously, up versus where we were last year, a little slowdown in the third quarter but the consumer continues to be a pretty robust there. Our business was up double digits in the third quarter. Obviously, a slightly easier comp versus where we were with the trucker strike, which partially hit us in the third quarter last year. But again, as I look at Brazil, and quite frankly, Latin America, good pricing, good volume, following good pricing that we took in the second quarter of 2019. So after aggressive pricing, we saw volume come back very nicely across the region. And we think that really bodes well for the underlying health of Latin America, specifically Brazil looks pretty good.

Mexico, on the other hand, a little softer. We saw a little softness in the quarter versus what we've seen in the first half of the year. I think there is some uncertainty in terms of politically and economically where things are going there. Our strategy is the same. We're focused on premiumization. As I mentioned earlier, the total business is performing exceptionally well in that market. We're pushing naturals, natural ingredients into the portfolio as well. We've seen that as a significant ASP premium to the market. We are pushing sensitivity in that market. We have seen some nice growth on that as well. So overall, it's a premiumization strategy across the region. But as we see some of the markets slow, specifically Mexico, we will dial that up.

Operator

And next, we'll go to Andrea Teixeira with J.P. Morgan.

Andrea Teixeira

Hi. Thank you for squeezing me in. If you can speak a little bit on Asia Pac, it showed the sequential improvement on the headline but not on a two-year stack. But particularly on the volumes, I think you kind of -- you inflected volumes there and you accelerated. Is that related to the -- can we read into the China destocking and improvement that you called about in the second half? Is that how you see? Is that according to plan? Anything you'd call out on China or Asia Pac in particular? Thank you.

Noel Wallace

Sure. Thanks, Andrea. Yes, we're pleased. Obviously, as John mentioned, with Asia, it's a little ahead of our expectations. We saw growth across every one of our hubs. It was broad-based and strong in terms of volume and price. And we feel that the momentum we have across Asia will continue. The particular call out was China. Obviously, a journey to get here, and we feel the strategies we've put in place in terms of our go-to-market changes, our portfolio changes, how we're working across the different retail environments, particularly online and the structural changes that we made in that organization are all starting to pay off, as we saw China deliver its first positive organic since Q4 of 2017.

So again, it's been a while to get there, but we feel we're in a very good place and we'll continue to see that growth accelerate as we move into the fourth quarter and as we look at the 2020 plans, we would certainly hope to see that business continuing to grow. We realize that a lot of our competitors are getting significant growth out of China, so this bodes well that we continue to see our business accelerate and the strategies that we've put in place are starting to work.

Operator

Moving on, we'll go to Mark Astrachan with Stifel.

Mark Astrachan

Two questions, I guess. One is just on Hill's. Maybe talk about how you're thinking about sustainability? Maybe was there any benefit from incremental channel fill from some of the new product launches in the U.S. in particular and just kind of how you're thinking about that?

And then back to gross margin, I guess I'm a little surprised. You're surprised at what happened in the quarter. You talked about taking pricing on Hill's early in the quarter, so you had some idea there. It seems that there was going to be some pressure. North America was the category that had the -- geography that had the most pressure kind of in your backyard. So, when we were on the phone at the end of July, I mean, how much of this did you know at that point? What kind of visibility, then do you have at this point to tell us that you expect improvement in 4Q and going forward?

Noel Wallace

So, let me talk about the sustainability in the Hill's business first, then we'll talk about pricing and margins again. Obviously, on Hill's, that business is hitting on all cylinders right now. They're expanding our presence in store, I think because the trade sees the sell-ins of the brand and how important it is to consumers in terms of how we're positioning the brand itself, and the messaging and the benefits that come with that. The pricing has stuck. The pricing you mentioned, Mark, was not in the second quarter. We've just taken pricing in the fourth quarter. So at the end of September, we took additional round of pricing on both our Hill's Science Diet business as well as the prescription diet business.

So, that will hit us more in the fourth quarter, as we see the benefits of that coming through the P&L. We're in the midst of rolling out the Science Diet business globally. We've started in Latin America. It's moving into Asia in Japan, as well as Europe. And we've seen the early indications are like we've seen in U.S., so that bodes well for the sustainability of that business moving forward.

What I also mentioned earlier is that we have really dialed up our innovation and are focused on the prescription diet part of the business, which is, you'll start to see those plans unfold in 2020. And we're certainly confident that, that business is going to continue to drive good results. Obviously, the quarter was exceptional. I'm not suggesting we're going to see double-digit growth in the fourth quarter or 2020 but we will see good strong growth as well as margin expansion as we move into 2020.

Listen, on the mix issue, it was surprise for us, Mark. If you look back historically, we've always had positive or no impact on mix relative to our business. We saw some geographic issues. We saw some category issues in the quarter and we didn't anticipate that as we moved in -- as we moved through the second quarter discussion. As we moved into the quarter, it looked fine. As we went through the balance of the quarter, it got a little bit more challenging.

And so we're on that. We are addressing that and have the right discussions with the teams moving forward. We, obviously, are a little bit more FX-ed that came through the P&L, than expected as well. That was a surprise to us. We were all hopeful that given the strong FX hits that we had last year, that we would see a more benign environment that picked up in the quarter. The good news is that's dropped back and we see spot rates coming back today. And we're hopeful that those spot rates will hold. But the surprise there was both mix and FX, and as I mentioned earlier, some of the raw packing materials that we saw come through the P&L as well.

Operator

And I'd like to turn it back to our presenters for any additional or closing comments.

Noel Wallace

No, thanks. Again, I appreciate the questions. We're on the gross margin discussion. 90 days through the quarter, we'll get that addressed moving forward. Obviously, the top-line sequential growth looks terrific for the business. It's broad-based across all of our categories, as well as both emerging and developed markets.

As we look to the first quarter, we will come back to you with, obviously, a lot more specificity in terms of guidance for 2020. Let me again thank the 35,000 Colgate people who have worked so hard to deliver that sequential growth in the P&L, which looks terrific. And we look forward to continue discussions as we move into the fourth quarter and first quarter call. Thanks so much.

Operator

And it does conclude today’s conference. We would like to thank everyone for their participation. You may now disconnect.