Q3 FY 2020 (JFM'20) Earnings Webcast

Jon R. Moeller
Vice Chairman, Chief Operating Officer and Chief Financial Officer

Friday, April 17, 2020

Voiceover:

P&G would like to remind you that today's presentation includes 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.

Additionally, the Company has posted on its investor relations website – www.pginvestor.com – a full reconciliation of non-GAAP and other financial measures.

P&G Vice Chairman, Chief Operating Officer and Chief Financial Officer Jon Moeller:

Thank you.

Good morning. I'm here at home, by myself, coming to you through my cell phone.

John Chevalier is at his home and is prepared to jump in if, for any reason, my connection fails and I can't reestablish it.

We are all going through a difficult and challenging time. Let me start by expressing our sincere hope that you and your families are safe and are well.

Thank you for joining us on accelerated timing. Our motivation in advancing the timing of this release was simply transparency…getting information to you, to the market, as quickly as possible.

We've had a very strong quarter. I'm going to start by outlining our priorities in this crisis period. These have been and will continue to guide our actions and our choices. I'll then move quickly to strategy - which remains unwavering. I'll discuss actual and potential results for three time periods - the quarter we just completed, which, as I said, was strong; the long term…on the back side of this crisis; - and then the short- to midterm, as we all work our way through this. Following this, I'll answer a couple of anticipated questions, and then turn to additional questions that are on your or your clients' minds.

Our first priority in this crisis is to ensure the health and safety of the men and women we work with - our colleagues - around the world.

Second, we're maximizing the availability of products that help people and their families with their health, hygiene and cleaning needs, which have never been greater.

The next priority is helping society meet and overcome the challenges they face.

Taken together, these priorities help ensure P&G is there – there for employees, there for consumers and there for communities - who have always been there for us.

Let me briefly discuss each of these priorities in turn.

Employee safety and health:

With guidance from medical professionals, we're constantly evaluating and updating the robust measures already in place to help our people who are making, packing and shipping P&G products stay safe at work. This includes temperature scans, shift rotations, queueing avoidance, and physical distancing. We're performing comprehensive, methodical cleaning of all production areas, including regular sanitization and surface disinfection that exceeds the most rigorous health authority standards.

We're also equipping and encouraging all employees to make smart, appropriate choices, such as staying at home if they feel unwell, are part of high-risk groups, or have pre-existing medical conditions. In all cases, we're partnering with our colleagues individually and proactively to ensure they feel - and are - protected and safe. This has never been more important, as many of our facilities are running around-the-clock to deliver P&G products during this period of increased demand.

Our industry-leading benefits plans play a critical role in providing P&G people with the resources they need to care for themselves and their families. From paid leave and comprehensive medical care, to flexible work arrangements and financial support, P&G people can work confidently knowing the Company stands with and behind them. It's very inspiring to witness the many acts of service people are taking to support and care for each other, demonstrating creativity, flexibility, and commitment - truly P&G people at their best.

Turning to product availability:

P&G products play an essential role in helping consumers maintain proper hygiene, personal health and healthy home environments. Our products clean your laundry, your home, your hair, your body, your hands, and we clean and shave your face. We provide hygiene products for feminine protection, baby care, adult incontinence, and bathroom needs.

Hair Care - shampoos to clean hair and conditioners and treatments to improve hair health. Facial cleansers, body wash, hand soaps and anti-perspirants and deodorants - address additional hygiene needs.

Our OTC health care products provide proactive health benefits as well as important symptom relief.

These products are more important than ever given the needs presented by the current crisis, the increased awareness around health and hygiene, and the additional time many of us are spending at home.

Consumption of hand soaps has obviously increased.

Consumers in the U.S. are doing more laundry loads per week and washing more garments after wearing them just once. More loads are being done with unit dose detergents. We've seen a spike in demand for Tide Anti-Bacterial Spray.

Dish Care consumption has increased as families eat more meals at home and are more concerned about the hygiene of their dishes, glasses, and silverware.

More meals at home means more surface cleaning, often with a preference for disposable cleaning solutions versus a funky sponge, cloth, or suspect mop - leading to increased consumption of Bounty, Swiffer, and Mr. Clean.

In late-February, we launched Microban 24, with antimicrobial technology that keeps surfaces sanitized for up to 24 hours when used as directed. The power behind Microban 24 is a multi-layer protective shield that binds the bacteria-fighting ingredient to the surface that's being cleaned, even when contacted multiple times, helping homes stay cleaner and more hygienic, longer.

We've been working lockstep with governments around the world to ensure we can continue to operate, enabling us to help people and their families meet their health, hygiene and cleaning needs.

Our operations remain resilient. As of today, our 108 manufacturing plants, along with our network of external supply partners, are broadly operational, with only a few at modified capacity as a result of regulation, workforce travel restrictions, curfews, material availability or quarantine needs.

March was a true test for our product supply planning and logistics organization - which they passed with flying colors. We set records for volume of product produced and shipped. Our largest five North America plants produced and shipped 22% more cases in March than the average of the prior 12 months. The P&G supply organization delivered similar records across Europe, Latin America and other parts of the world. Incredibly impressive.

Moving to the next priority, P&G has a long history of supporting communities in times of need - with the products we produce and other forms of support.

P&G donations of product and cash support are significant and will continue to increase as we work with communities around the world to support their efforts to help people through this crisis.

Millions of P&G products are being donated, helping to ensure that families have basic access to the everyday essentials many of us take for granted.

We're partnering to provide additional support with some of the world's leading relief organizations, including the International Federation of Red Cross, Americares and Direct Relief, and key regional organizations such as Feeding America, Matthew 25: Ministries, the China Youth Development Foundation, One Foundation, the Korea Disaster Relief Association, The United Way, and more.

We're working to protect health care workers and first responders. The United States Center for Disease Control has issued guidance recommending proper shaving when wearing N95 and similar respiratory masks in order to ensure proper mask fit for protection. Gillette is donating razors around the world to hospitals and other facilities to protect the people working to care for others.

We have modified equipment to produce hand sanitizer in nearly a dozen manufacturing sites around the world, using it to ensure our people can continue operating safely and sharing it with hospitals, health care facilities and relief organizations.

Colleagues in our Gattatico plant in Italy volunteered to create an extra shift to produce surface cleaning and sanitizing products that are being donated to 70 hospitals across that country.

Work is underway to produce critically needed non-medical face masks. We're already up and running in China and the US. We currently have teams working to install additional capacity in every region of the world and will quickly begin production in the coming weeks. When fully operational in July, we expect to be producing more than 10 million masks per month.

We have leveraged P&G R&D, engineering and manufacturing capability to quickly produce face shields in Boston and Cincinnati, which are currently being used in hospitals and COVID-19 testing centers.

We're using our marketing and communications expertise to encourage consumers to support public health measures to help flatten the curve and slow the spread of the virus.

P&G is committed to the priorities of ensuring the health and safety of our employees; maximizing availability of products and helping society overcome the challenges of this crisis.

Our strategic choices remain the right ones and serve each of these priorities.

A portfolio of daily use products, many providing health, hygiene and cleaning benefits in categories where performance plays a significant role in brand choice.

Superior, science-based products delivered with superior packaging, retail execution, consumer communication and value…in all price tiers where we compete.

As you know, we've made investments to strengthen the long-term health and competitiveness of our brands, and we'll continue to invest to extend our margin of advantage and quality of execution, improving options for consumers around the world.

The strategic need for this investment…the short-term need to manage through this crisis…and the ongoing need to drive balanced top and bottom-line growth… including margin expansion…each underscore the continued importance of productivity.

We're driving cost savings and efficiency improvement in all facets of our business, in our second, five-year, $10 billion dollar productivity program. Cost productivity and cash … up and down the income statement and across the balance sheet.

Success in our highly competitive industry requires agility that comes with a mindset of constructive disruption. A willingness to change, adapt, and create new trends and technologies that will shape our industries for the future.

In this environment, that agility and constructive disruption mindset are even more important. How can we be even safer while both producing and helping more? What new needs must we meet? In what new ways? An ongoing mindset of constructive disruption and disruptive possibility.

Our new organization structure…six industry-based Sector Business Units that manage our 10 product categories…with a differentiated approach in Focus Markets and Enterprise Markets …. and very small Corporate groups with best in class function expertise …. is serving us well. A more empowered, agile and accountable organization with little overlap or redundancy, flowing to new demands, seamlessly supporting each other to deliver our priorities around the world.

These strategic choices we've made -to focus and strengthen our portfolio in daily use categories where performance drives brand choice…to establish and extend the superiority of our brands…to make productivity as integral to our culture as innovation… to lead constructive disruption across the value chain…and to improve organization focus, agility and accountability - are not independent strategies. They reinforce and build on each other.

As we said at CAGNY, the best response to the uncertainties and sources of volatility we face is to double down on this integrated set of strategies, which are delivering very strong results. These integrated and mutually reinforcing strategies are a foundation for strong, balanced growth and value creation. The best response to what we are challenged with today is to push forward, not to pull back, and that's exactly what we intend to do.

I want to now describe how this approach has played out in the quarter we just completed and how we think it could play out across both the longer term and the arguably more challenging short-to-midterm.

First, as I said, strong results in the January-March quarter.

When we spoke with you at the CAGNY Conference on February 20th, we said results for the January to March quarter – in China and for the total Company - would be materially impacted on both the top and bottom line by the dynamics affecting the market in China.

At that point in time, COVID-19 was really just a China…and travel retail…issue. Korea had reported only 50 cases. The U.S., Japan, Italy, and Iran …combined…had reported only 30 cases. (15, 10, 3, and 2 respectively)

At CAGNY, we were internally expecting organic sales in Greater China, our second largest and second most profitable market, to be down as much as 20%.

Through the incredible efforts of our organization, we did much better than we expected in Greater China…down only 8%, excluding travel retail. We saw a strong lift in our categories in e-commerce to make up a portion of sales lost in closed physical stores. We quickly restored production capability, built share as a result and are now operating at very close to full strength.

As the pandemic unfortunately developed in the U.S. and Europe as the quarter progressed, demand surged. We finished the quarter with organic sales growth of 10% in the U.S., 14% in Canada, 6% in European Focus markets, 15% in European Enterprise markets and 11% in Latin America.

At CAGNY, we were internally projecting Q3 organic sales growth for the company of around 2%. We delivered 6%.

With 9 of 10 categories growing organic sales.

We built aggregate share, despite temporary out-of-stocks on some of our highest demand items.

While we don't have final U.S. all-outlet share data through March, share results in tracked channels through March show broad-based growth. Vicks respiratory products were up more than 4 points. Metamucil and Pepto Bismol up 3 points. Olay moisturizers and Oral B power toothbrushes up more than two points. Always pads, Always Discreet, Tampax, Tide, Dawn, Cascade and Gillette Blades & Razors each up a point or more. Pantene, Head & Shoulders, Old Spice, Native, Secret, Crest, Mr. Clean, Gain and Bounce…each growing share.

As you can see in the tracked channel data, our share declined recently in Baby and Family Care categories due largely to out-of-stocks on our high demand brands. We're pushing production to its limits, but we expect share softness to continue while consumer pantry stocking remains at extreme levels.

In China, we built share in offline stores and in e-commerce. Safeguard and Gillette delivered strong share performance in both channels. Head & Shoulders was particularly strong offline, and Olay, Whisper and Pampers posted solid online share growth.

Top-line results this quarter obviously benefitted from consumer pantry loading in preparation for in-home quarantining. We are planning for pantry inventory levels to eventually return to normal.

This high level of consumer demand was served with our ramp-up in production levels and the depletion of retailer inventories. As at-home inventory decreases, we expect to re-fill the retail inventory pipeline.

We believe the net effect of all of this shifted about two points of sales growth from Q4 into Q3.

Back to CAGNY, we were expecting a slight decline in core EPS for the quarter. We delivered $1.17 per share, an increase of 10%. The significant volume and sales increase, related fixed cost leverage, and our ongoing productivity efforts more than offset a growing FX challenge and higher virus-related operational costs. Commodities also provided a benefit.

Core gross margin up 120 basis points. Excluding currency up 130. bps.

Core operating margin up 100 basis points. Currency neutral core operating margin up 180 basis points.

Core EPS up 10%. Currency neutral core earnings per share up 15%.

$4.1 billion dollars in operating cash flow. Adjusted free cash flow productivity at 113%, returning 2.8 billion dollars in cash to shareholders - 1.9 billion in dividends and $900 million in share repurchase.

So, January-March - 6% organic sales growth. 10% core earnings per share growth. 113% free cash flow productivity. Building share.

Fiscal year to date: 6% organic sales growth. 16% Core EPS growth. Over 100% adjusted free cash flow productivity. Building share.

Just two days ago we announced a 6% increase in our dividend, reflecting both these results and the confidence we have in our future. This was the 64th consecutive annual increase, and the 130th consecutive year in which P&G has paid a dividend.

So, that's January through March and fiscal year to date. Very strong results in very difficult conditions.

Shifting to longer term. We remain well-positioned to serve consumers and create value…in a very attractive industry. And, as I said previously, our strategy to oo this is unwavering.

Consumption of our products is not likely to dissipate. In fact, the relevance of our categories in consumers' lives potentially increases. We will serve what will likely become a forever altered health, hygiene and cleaning focus for consumers who use our products daily…or multiple times each day.

There may be an increased focus on home…more time at home, more meals at home, with related consumption impacts.

The importance of noticeably superior performance potentially grows.

There is potential for increased preference for established, reputable brands that solve newly framed problems better than other alternatives. Potentially less experimentation.

Potential for a lasting shift to e-commerce, both e-tailers and omni-channel. Our experience to date makes us believe we are, generally, well-positioned in this environment.

Increased demand has focused retailers on the core SKUs that drive the business. There is potential for this to result in a cutting of the long tail of inefficient SKUs and brands in our categories.

We are discovering, daily, lower cost ways of working with fewer resources…today's necessity birthing the productivity inventions of tomorrow.

New digital tools are being brought to the forefront, providing another productivity rocket booster - on the factory floor and in the office environment.

So, in the longer term, we believe that we are relatively well positioned to serve consumers heightened needs and their changing behavior...to serve the needs of our retail and distributor partners across channels and geographies...and to create value.

In the short to mid-term, outcomes are frankly anyone's guess.

Epidemiologists still have wide variations in their best and worst case scenarios for viral spread, mortality - the shape and duration of the curve.

We may see months of sporadic production suspension due to local quarantines or raw material supply. It's not just our operations that matter here - it's those of our suppliers, of contractors, and of our transportation partners. A lot must go right - in a very challenging environment - and not all of it will.

Customers may close stores.

There will continue to be extreme foreign exchange and commodity cost volatility.

Added operational complexity will result in higher costs.

Unemployment will impact outcomes, perhaps severely.

All of this occurs on top of what was already unprecedented uncertainty and volatility in our categories and markets.

But, as you saw - in the development of the business in just five weeks - from CAGNY to March 31 - and, as we've just talked about in our long-term outlook - where there is volatility, there are opportunities to serve, as well as challenges.

There is a very wide range of possible near-term scenarios, and it's futile to spend too much time trying to assign probabilities to each. We'd be fooling ourselves...and fooling you...to try.

As we stand here today, though, we continue to believe our guidance ranges for the fiscal year - on both the top and bottom lines - remain relevant. Our internal forecasts remain within these ranges, but I must again emphasize ranges, and I must again emphasize the degree of uncertainty and volatility we face day to day.

We currently expect organic sales growth for the year in the range of 4 to 5% assuming continued operations - at our facilities and those of our customers and suppliers.

On the bottom line, we are still forecasting core earnings per share growth in the range of 8 to 11% for the year. This, too, assumes no significant interruption in the extended supply chain through to our retail and distributor partners.

This EPS range now includes over $400 million dollar of after-tax foreign exchange headwinds. Just since CAGNY, FX has moved against us by approximately $0.10 per share, over 2 percentage points of Core EPS growth on the year. In the fourth quarter, FX is currently forecast to be a 7 point hit to Core EPS growth.

Please recall that our fourth quarter bottom-line comps include the earnings gains from the Boston land sale and the divestiture of two oral care brands in the base perod. These items, combined, are an additional 7 point headwind to Core EPS growth in Q4.

While we do expect some mid-term benefit in commodity costs from the recent declines in oil prices, it usually takes about six months for movements in feedstocks like oil to make their way through the raw material supply chain to our P&L. Net, we don't expect an offset to FX headwinds from lower commodity costs within this fiscal year.

As a result of all this, you might rightly guess that we are closer, on this day, to the bottom end of the range than the top end.

Let me also go back, quickly, to our priorities and note that none of the three include hitting quarterly consensus estimates. We will be focused on serving - colleagues, consumers, customers, communities - building our business for the many more months that will follow this crisis than the months that will exist in it - but we will do this responsibly...and keep our choices squarely centered on mid and long-term value creation.

We continue to expect adjusted free cash flow productivity of 100%.

We will extend our long track record of significant cash generation and cash returned, expecting to pay over $7.5 billion dollars in dividends and share repurchase in the range of 7 to $8 billion dollars in fiscal 2020.

We'll provide our first outlook for fiscal 2021 on our year-end call, as we typically do, in July.

Before turning to your questions, I want to address just two items that I expect are on your minds.

The first one is liquidity. Our liquidity status remains very strong. We're a 183 year old company this year, and we take a long term view to balance sheet management. We aim to maintain our AA- credit rating and to manage within the ratios that support that rating. With a $5 billion term issue three weeks ago at approximately of 3.0%, we now have $15 billion dollars in cash on hand and are generating more each day. We continue to have open access to the US Commercial Paper markets, recently issuing over $3 billion in three-month paper as part of our routine financing efforts. The amount of debt maturing in the next 18 months is well within anticipated cash availability. And, while we don't expect to need to draw on them, we have $8 billion in bank credit lines available if needed.

Less credit – very strong.

The second topic is recession. We're assuming it's already here and will be here for some period of time. While we are not immune, our current strategy puts us on better footing than prior downturns to weather economic headwinds.

Our portfolio is now focused on daily use items where performance drives brand choice. We have much less exposure to discretionary items than we had during the last downturn. We've increased the superiority of our offerings simultaneously increasing their value. While not perfect, we have stronger entries across price tiers. We are emphasizing performance-based, value messaging. We will serve with relevant pack sizes designed to hit key cash outlay thresholds for consumers who need to make week-to-week purchase decisions based on cash availability.

Our productivity muscle is now well developed.

None of these make us recession-proof, but they should each help.

Summing up, the men and women of P&G, working together, delivered three very strong quarters…averaging 6% organic sales growth, 16% Core EPS growth and over 100% adjusted free cash flow productivity. We built market share. Our Board has increased the dividend 6%, reflecting both strong results and confidence in the future.

We really do believe there is a very bright future ahead.

We will manage the short-to-midterm consistent with the strategy we've outlined many times and against the immediate priorities of ensuring employee health and safety, maximizing availability of our products to serve health, hygiene, and cleaning needs and helping society overcome the challenges of this crisis.

We're stepping forward, not back. We're doubling down to serve consumers and our communities. We're doing this in our interest, in society's interest, and in the interest of our long-term shareholders.

While we may not see you in person soon, we look forward to engaging with you on phone and would love to hear your voice. We are here with you …and are here for you.

Feel free to call our offices as you normally would. Our phones know where to find us.

With that, I'll be happy to take questions.

information, future events or otherwise, except to the extent required by law.

Risks and uncertainties to which our forward-looking statements are subject include, without limitation: (1) the ability to successfully manage global financial risks, including foreign currency fluctuations, currency exchange or pricing controls and localized volatility; (2) the ability to successfully manage local, regional or global economic volatility, including reduced market growth rates, and to generate sufficient income and cash flow to allow the Company to effect the expected share repurchases and dividend payments; (3) the ability to manage disruptions in credit markets or changes to our credit rating; (4) the ability to maintain key manufacturing and supply arrangements (including execution of supply chain optimizations and sole supplier and sole manufacturing plant arrangements) and to manage disruption of business due to factors outside of our control, such as natural disasters, acts of war or terrorism, or disease outbreaks; (5) the ability to successfully manage cost fluctuations and pressures, including prices of commodities and raw materials, and costs of labor, transportation, energy, pension and healthcare; (6) the ability to stay on the leading edge of innovation, obtain necessary intellectual property protections and successfully respond to changing consumer habits and technological advances attained by, and patents granted to, competitors; (7) the ability to compete with our local and global competitors in new and existing sales channels, including by successfully responding to competitive factors such as prices, promotional incentives and trade terms for products; (8) the ability to manage and maintain key customer relationships; (9) the ability to protect our reputation and brand equity by successfully managing real or perceived issues, including concerns about safety, quality, ingredients, efficacy or similar matters that may arise; (10) the ability to successfully manage the financial, legal, reputational and operational risk associated with third-party relationships, such as our suppliers, contract manufacturers, distributors, contractors and external business partners; (11) the ability to rely on and maintain key company and third party information technology systems, networks and services, and maintain the security and functionality of such systems, networks and services and the data contained therein; (12) the ability to successfully manage uncertainties related to changing political conditions (including the United Kingdom's exit from the European Union) and potential implications such as exchange rate fluctuations and market contraction; (13) the ability to successfully manage regulatory and legal requirements and matters (including, without limitation, those laws and regulations involving product liability, product and packaging composition, intellectual property, labor and employment, antitrust, data protection, tax, environmental, and accounting and financial reporting) and to resolve pending matters within current estimates; (14) the ability to manage changes in applicable tax laws and regulations including maintaining our intended tax treatment of divestiture transactions; (15) the ability to successfully manage our ongoing acquisition, divestiture and joint venture activities, in each case to achieve the Company's overall business strategy and financial objectives, without impacting the delivery of base business objectives; (16) the ability to successfully achieve productivity improvements and cost savings and manage ongoing organizational changes, while successfully identifying, developing and retaining key employees, including in key growth markets where the availability of skilled or experienced employees may be limited; and (17) the ability to successfully manage the demand, supply, and operational challenges associated with a disease outbreak, including epidemics, pandemics, or similar widespread public health concerns (including the novel coronavirus, COVID-19, outbreak). For additional information concerning factors that could cause actual results and events to differ materially from those projected herein, please refer to our most recent 10-K, 10-Q and 8-K reports.