

Edgewell Personal Care Company

2nd Quarter Fiscal 2017

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CORPORATE PARTICIPANTS

Chris Gough – *Vice President, Investor Relations*

David Hatfield – *Chief Executive Officer*

Sandy Sheldon – *Chief Financial Officer*

PRESENTATION

Operator

Good morning, and welcome to Edgewell Personal Care Company's 2nd Quarter Fiscal 2017 Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then one on your touchtone phone. To withdraw your question, please press star, then two. Please note, this event is being recorded.

I would now like to turn the conference over to Chris Gough, Vice President, Investor Relations. Please go ahead.

Chris Gough

Thank you. Good morning, everyone, and thank you for joining us for Edgewell's 2nd Quarter Fiscal 2017 Earnings Conference Call. With me this morning are David Hatfield, our President, Chief Executive Officer and Chairman of the Board; and Sandy Sheldon, our Chief Financial Officer. David will kick off the call then hand over the call to Sandy for the earnings outlook and for earnings and outlook discussion followed by Q&A. This call is being recorded and will be available for replay via our website, www.edgewell.com.

During the call, we may make statements about our expectations for future plans and performance. This might include future sales, earnings, advertising and promotional spending, product launches, savings and costs related to restructuring, changes to our working capital metrics, currency fluctuations, commodity costs, category value, future plans for return of capital to shareholders, and more.

Any such statements are forward-looking statements which reflect our current views with respect to future events. These statements are based on assumptions and are subject to various risks and uncertainties, including those described under the caption Risk Factors in our Annual Report on Form 10-K for the year ended September 30, 2016, as amended and supplemented in our quarterly reports on Form 10-Q for the quarter ended December 31, 2016.

These risks may cause our actual results to be materially different from those expressed or implied by our forward-looking statements. We do not assume any obligation to update or revise any of these forward-looking statements to reflect new events or circumstances.

During this call, we will refer to certain non-GAAP financial measures. These non-GAAP measures are not prepared in accordance with generally accepted accounting principles. A reconciliation of the non-GAAP financial measures to the most directly comparable GAAP measures are shown in our press release issued earlier today, which is available in the Investor Relations section of our website. Management believes these non-GAAP measures provide investors valuable information on the underlying trends of our business.

With that, I would like to turn the call over to David.

David Hatfield

Thank you, Chris, and good morning, everyone. Before Sandy takes you through the results, I'll briefly comment on sales and category trends in the quarter, the impact to our outlook for sales in fiscal '17, and our priorities for driving growth going forward.

Overall, we met our outlook on the top and the bottom line this quarter, despite strong competitive pressure and a pretty significant sequential deceleration of growth across all of our categories in the US.

In Wet Shave, we continue to compete well, gaining share globally and in the US in men's, women's, and disposables. And in terms of sales, we returned to a growth internationally and we grew women's and disposables on a global basis. However, sales declined in the US behind category softness and a tough comp to a year ago against our Hydro next-generation launch.

Sun and Skin Care sales were strong in both North America and International. North America sales were heavily influenced by the timing of customer order patterns versus year ago. But overall, we're pleased with the start of the season, the new products we're offering, and the incremental distribution we're getting.

Our Fem Care performance in the quarter came in below expectations as soft category metrics and intense competition added to the anticipated declines in sport pads and liners.

As we look to the remainder of the year, our revised top line outlook is for flat or organic sales versus a year ago, reflecting the incremental weakness in Fem Care as well as our expectation of continued category softness in the US Wet Shave. It's difficult to predict where the categories will go from here. But based on what we saw in the second quarter, our outlook does not assume a material improvement, particularly in the measured Wet Shave category in the light of expected competitive pressure.

This has been a difficult environment over the past several quarters. But despite that, we've competed well and going forward, we expect to continue to compete well.

So, let me spend a few minutes just discussing our strategies and the drivers of growth going forward. Our first strategic pillar is to continue to focus on and improve our fundamentals by one, building brand equities, by increasing consumer engagement; two, continue to deliver compelling innovation; three, leverage our full portfolio in Wet Shave to better serve all consumer segments and pricing tiers; and, four, deliver unique and effective category solutions in each of our segments.

Now, however, that alone won't be enough to drive sustained growth. The external environment is rapidly changing, reflecting quickly changing consumer behavior and has the purchase empowered by digital and the mobile, new and increasingly aggressive competitors, and continued channel shifting and the evolution.

With the challenges that come with these changes also comes opportunities. The goal of our second strategic pillar is to rapidly reconfigure our business against those growth opportunities that we see in the marketplace in investing in them to accelerate top line over the medium term. Some of the areas that we're focused on are, first, significantly growing our e-retail business. We've gained share within Omni-channel and in pure play e-retail channels in each of the last three years. However, we remain under-indexed in these channels, and as we organize, resource, and invest in this area, we see significant growth potential. For example, we just launched our first shaving flagship store with Tmall, the leading e-commerce site China.

Second, launching our own direct-to-consumer sites. Here, we think about the opportunity less in the terms of short-term sales and more in the terms of strengthening our digital capabilities, generating new consumer insights, and supporting our overall e-commerce efforts. We think we've developed a unique and a differentiated proposition that accomplishes this, builds brand equity, and complements our

overall channel strategy. We plan to launch it first in the US in the next month or so.

Third, targeting and investing in the key growth channels beyond e-retail around the world like club, value channels, etc. Four, continuing to pursue disciplined M&A to enter new growth categories and adjacencies. For example, our Bulldog acquisition is going very well, and we're encouraged at our ability to expand it geographically. We would love to replicate this model and build on the Bulldog example.

And finally, continuing to expand our international scale and footprint. We've been growing our international business in the mid-single digits. We look to accelerate that growth through investment into China both on and offline, continued expansion of Sun Care markets, and the rollout of Bulldog and other grooming products.

To realize those goals, our third strategic pillar is to build organizational capabilities and generate resources and funds to support these initiatives and fund these investments. For example, our ZBS initiative is progressing well and we're working to institutionalize it as our way of doing business. This complements several productivity projects that are well underway, including trade spend and the marketing mix management, where we're looking for continuous improvement on event lists and ROI.

Finally, we look to continue our strong track record of production cost improvement, driven by our continuous improvement culture and process, as well as footprint changes over time.

So, as we head into the second half of the fiscal year, I'm pleased with the great work done by our colleagues around the world who continue to drive results in the midst of a challenging and a changing world. We recognize and understand those challenges and are executing with urgency the three strategic pillars that I've just outlined.

We reorganized the organization recently to accelerate our efforts to realign our resources and investments against growth opportunities while continuing to focus on cost reduction and productivity. Because of those efforts, combined with our full Wet Shave portfolio and our robust innovation pipeline, we're confident we can drive growth over the medium term and deliver on our bottom line goals and a balanced financial algorithm.

Thanks. And with that, I'll hand it over to Sandy.

Sandy Sheldon

All right. Thank you, David, and good morning, everyone. I'll cover our second quarter business performance beginning with a few headlines. Net sales in the quarter were \$611 million, flat on a recorded and organic basis with growth in Sun and Skin Care offset by declines in Wet Shave and Fem Care.

From a geographic perspective, North America organic net sales were down 1.4%, while International organic net sales increased 3%. We delivered \$136 million of adjusted EBITDA, and \$1.21 adjusted EPS in the quarter. Overall, these results are in line with our outlook to the first half of the year and we're pleased with this progress particularly in line with the recent weakening category trends in the US.

Turning to sales, reported sales were flat in the quarter and also flat on an organic basis excluding a \$2.9 million benefit from the Bulldog acquisition, and a \$3.7 million negative impact from currency. Lower volumes of approximately 2% were roughly offset by improved price mix and lower promotional spend. Segment results vary, but improved volumes were most notable in Sun and Skin Care due

largely to timing, but also improved distribution.

Strength in Sun and Skin Care helped partially offset lower Feminine Care and Wet Shave volumes. Price mix was favorable across all segments on lower promotional spending, as well as improved pricing in international. I'll review more details of these drivers from a segment perspective in a few minutes.

Turning to gross margin, gross margin was 50.7%, a decrease of 20 basis points as favorable price mix and volume growth in Sun and Skin Care were more than offset by lower volumes in Wet Shave and Feminine Care and higher product costs related to the transition of Feminine Care manufacturing from Montreal to Dover, Delaware.

A&P expense as a percent of net sales was 13.5%, down 40 basis points, primarily driven by the higher level of spending last year in support of the rollout of the new Hydro products.

SG&A expense was 17% of net sales. Excluding prior year spin-related costs, SG&A increased 6%, primarily driven by investments we're making in the current year in support of zero-based spending and the growth opportunities that are part of our strategies. As David discussed, we're investing to reconfigure our business to better leverage the growth opportunities we see in the marketplace in order to accelerate top line over the medium term. In particular this quarter, we ramped up spending behind both China and e-commerce growth initiatives. We expect to see the benefits of our zero-based spending initiatives begin to positively benefit SG&A as we move through the second half of the year.

Other income was \$6.6 million compared to \$4.6 million in the prior year primarily reflecting the impact of a net gain from foreign currency contracts and revaluation of non-functional currency balance sheet exposures.

Interest expense was down compared to the prior year reflecting lower debt levels this year. And the effective tax rate was 26.2% versus 26.4% in the prior year. Excluding tax associated with restructuring expenses, the effective tax rate was 26.6%, 150 basis point improvement from the prior year due to a more favorable mix of earnings in lower tax rate jurisdictions. Net of all these factors, GAAP diluted EPS was \$1.14 in the quarter as it compared to \$1.10 in the prior year and adjusted EPS for the quarter was \$1.21 compared to \$1.17.

Net cash used by operating activities was \$0.4 million for the first six months of fiscal 2017 compared to approximately \$73 million in the prior year. The improvement reflects discretionary funding of certain international pension plans of approximately \$100 million in the prior year, partially offset by higher current year deferred compensation payments, as well as increased net outflows from working capital driven by the timing of receipts and payments, including a tax refund received in the prior year.

Cash flow from operations and free cash flow is expected to be generated in the second half of the year. And therefore, we continue to estimate positive operating cash flow for the full year and expect free cash flow to be approximately 100% of GAAP net earnings.

So, those are our results on a total company basis. Let me now turn to our segment results. Starting with Wet Shave, organic net sales decreased 2.2% in the quarter, largely driven by volume declines in North America men's systems as expected and overall US category softness, while International Wet Shave net sales returned to growth. The volume declines were partially offset by lower promotional spend and pricing.

We grew sales in both women's systems and disposables globally as we had good initial performance

from new innovation, including improved Hydro Silk for women and the new Quattro YOU disposable for women, as well as distribution gains in disposables, notably in the US and Latin America.

Within men's systems, North America declined 23% this quarter versus significant growth of over 32% last year, driven by the next-generation Men's Hydro launch and new distribution. Importantly, the North America men's segment sales improved on a two-year basis.

Internationally, men's systems net sales was relatively flat, a sequential improvement versus the first quarter, reflecting some improvement in Japan's top line results as we execute new pricing we discussed last quarter.

Rounding out Wet Shave, Shave Preps declined approximately \$1 million in the quarter, showing improved performance compared to the first quarter of fiscal 2017 as anticipated. Wet Shave segment profit decreased nearly 6%, driven by the volume decline in men's, partially offset by pricing and lower promotional and A&P spending.

Turning to the category, we did see a material slowdown across all measures within the quarter. As measured by Nielsen, the US manual shave category was down over 9% in the latest 12-week data with declines in men's systems, women's systems, and disposables. Men's manual shave was down over 12%. When factoring in non-measured channels, we believe the US men's category was down around 4%, driven by online growth, with the overall razors and blades category down about 5%.

From a share perspective versus a year ago, we were up slightly globally and our US share was up 60 basis points in manual shave, driven by share gains in men's, women's, and disposables. This increase marks the eighth consecutive quarter of share gains in the US manual shave.

Sun and Skin Care net sales increased nearly 14%, including the positive impact of the Bulldog acquisition. Organic net sales increased over 12% in the quarter, driven by volume growth in North America and International. Growth in North America, up over 11% on an organic basis, was largely volume based due to the timing of shipments by quarter versus a year ago, and also benefited from new product distribution and improved baselines. These improvements were partially offset by the impact of exiting private label this year, which was a drag of about \$3 million this quarter, with an estimated impact of \$9 million for the full year.

International also delivered double-digit organic growth, driven by improved consumption and new distribution in EMEA and Latin America. Segment profit increased \$11.7 million, driven primarily by higher volumes and improved costs, as we benefited from restructuring cost improvement projects. Within the US Sun Care category, consumption was down over 4% in the quarter. Keep in mind that second quarter consumption is typically only 10% of the full year category sales. Our US market share improved in the quarter in both Banana Boat and Hawaiian Tropic brands.

Just a quick update on Bulldog men's grooming product line. We remain pleased with the financial and market share results in the quarter, as well as commercial plans the team has put in place for the balance of the year. Integration is progressing well, with back office activities underway and international expansion plans in development.

Turning to Feminine Care, organic net sales decreased \$8.6 million or 9.4%. Sport-branded pad and liner net sales were down approximately \$3 million, as expected, due to distribution losses, which are expected to continue through the balance of the year. In addition, sales decreased across tampons, pads, and liners, driven by heightened competitive promotional levels, as well as category softness and reductions in trade inventory levels. The volume declines were partially offset by lower promotional

spend in the quarter versus higher support levels a year ago behind sport pads and liners.

Feminine Care segment profit decrease \$8.9 million driven by lower volumes, increased product costs related to the transition of manufacturing from Montreal to Dover, Delaware, and increased transactional currency impacts. Overall, the Feminine Care category was down slightly by 20 basis points, but down 1.6% in tampons and 1% in liners. Our market share declined 1.3 points.

We recently announced our launches for compact tampons, 30% smaller than full size, which makes it the most compact tampon on the market. This launch will fuel continued growth of sport tampons as we tap into the growing compact segment of the category.

Having said that, we anticipate heightened competitive promotional and product launch activity and continued baseline decreases in Gentle Glide tampons and pads and liners. So, we now expect net sales to trend similar to year-to-date trends for the remainder of the year. From a segment profit perspective, the transition start-up costs for pads and liners are anticipated to continue through the third quarter.

Finally, in our All Other segment, which is primarily Infant Care, organic sales increased 2.1% driven by strong growth in our Diaper Genie and Pet Care businesses this quarter. This was the sixth consecutive quarter of organic net sales growth in our Diaper Genie business, which has been a critical driver in stabilizing our Infant Care top line.

Turning to our full year outlook, we are revising our outlook for organic net sales to flat for the year, down from our previous outlook of a low-single-digit increase. This outlook reflects additional declines in Feminine Care and North America Wet Shave due to category softness and heightened competitive intensity and reflects growth in International Wet Shave in the back half of the year driven by several initiatives including the benefit of price increases, new product launches, as well as ongoing growth in emerging markets.

We also continue to see macroeconomic uncertainty and currency volatility and are not immune to the impacts of these. But based on our results through the first half, current spot exchange rates and what we know today, we're maintaining our previously stated outlook for adjusted EPS. We will continue to take a balanced approach to investment in the business for the long term and margin expansion in the year.

For the full fiscal year 2017, we estimate organic sales to be flat and we now estimate that reported net sales will be down approximately 1%. This includes an estimated 120 basis point headwind from currency and estimated 60 basis point benefit from the Bulldog acquisition. Our GAAP EPS outlook is now in the range of \$3.50 to \$3.70, and our adjusted EPS remains in the range of \$3.80 to \$4. Adjusted operating income margin is anticipated to expand by 50 basis points. The effective tax rate for the fiscal year is now estimated to be in the range of 26% to 27%.

The full year estimate for restructuring-related costs is now \$25 million to \$28 million, reflecting an estimated non-cash charge related to the disposition of real estate. We continue to expect incremental restructuring savings of \$20 million to \$25 million in 2017, and an additional \$20 million to \$25 million in 2018 and 2019. The Feminine Care production move to our Dover plant is now expected to be complete by the end of the third fiscal quarter and we expect to be fully out of the Montreal site before the close of our fiscal year.

Let me wrap up by addressing our zero-based spend initiative. The project continues to progress well, and we are moving into our first category level, zero-based budgeting process. In addition, all 11 of the

categories we have identified for this initiative are moving forward with implementation of savings projects.

Two-year savings goals have been established by category and we are putting the tools in place to make the savings sustainable, including enhanced visibility, reporting, and detailed savings tracking. Some of the key savings initiatives include advertising agency fee reductions with tighter control and monitoring of global spend, travel policy changes, reductions in facilities and lease costs, streamlining of market research across all geographies, optimizing sales support costs in all classes of trade, and assessing legal and insurance costs.

Through the first half of the fiscal year, net savings have been roughly \$4 million, and we expect to realize higher savings in the next two quarters as the projects ramp up. We continue to estimate we can deliver \$35 million to \$45 million in net savings over the next two years, including an estimate of \$10 million to \$15 million in savings for fiscal 2017.

Thank you. And with that, we'll open it up for questions.

QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session. To ask a question, you may press star, then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then two. Please limit yourself to one question and one follow-up. If you have further questions, you may re-enter the question queue. At this time we will pause momentarily to assemble our roster.

Our first question comes from Nik Modi with RBC Capital Markets. Please go ahead.

Nik Modi

Yes. Thank you. Good morning, everyone. Just a couple questions on the Wet Shave business. So, I found it interesting that you guys actually got pricing in the quarter and still gained share at the same time to what had the worst price mix performance, I think, since our model goes back to 2005 that I can remember. And I'm just trying to see if you can reconcile that. I mean, did you see any impact because I know they were highly promotional during the quarter? Is that part of your guidance already?

And then the second follow-up to that was just on the private label side. You've had some good success with the three-blade, just curious on how that's going and are you going to be expanding that to other retailers.

David Hatfield

Yes. Thanks, Nik. Maybe just to begin with the private label question, yes, we're actually right now rolling that out internationally, the Fits proposition. So, we're rolling that out around the world primarily in developed markets.

In terms of the price mix, we've been gaining share for the last eight quarters. We gained share in the last four, despite promotions from competition, promotional rates that are up in unprecedented territory for the last four. So, this is just kind of more of the same.

Sandy, I don't know if you have any other color to add.

Sandy Sheldon

Yes. So, we did get some pricing in the quarter as we started the price increase in Japan. So, some of that started this quarter, and we also had lower promotional spend, predominantly related to higher levels a year ago as we were supporting the new next-gen Hydro launch in the US. So I would say those are the two main factors.

David Hatfield

Yes.

Nik Modi

Great. And then just if I can slip in one more on Shave Clubs. I mean, some of the intel we've been picking up is that they are starting to kind of subside in terms of the growth rate as repeat rates aren't matching up to trial rates, and I'm just curious on if you've observed—what you've observed through your data.

David Hatfield

Yes. Yes. We're actually seeing similar trends. Now the data that we see has to be taken with a caveat. But we've seen them slow down sequentially over the last four quarters or five quarters, and in fact, this last quarter, the data that we have says they were actually down sequentially. So, we see similar trends.

Chris Gough

Thank you, Nik.

Nik Modi

Thank you.

Chris Gough

Thanks, Nik. Operator, next question, please.

Operator

Our next question comes from Stephen Powers with UBS. Please go ahead.

Stephen Powers

Great. Thanks. First, on Sun Care, on the US side, can you just clarify how much of that shipment timing was a catch-up from the prior quarter versus a pull-forward from Q3? And then internationally, the distribution gains that you made this quarter, do you think that level of strength is sustainable? And just really how do you size for the distribution opportunity?

David Hatfield

Yes. For the pull-in and pull-out, we see a large portion of the US growth being timing, whether it be from Q1 in or Q3 going into Q2. We see the pull-forward from the Q3 being roughly \$7 million to \$8 million of the growth.

Internationally, we see continued growth both driven by consumption and a philosophy where we're handled, as well as increased distribution into either new countries or new customers. So, we see international growth continuing through the year, and into '18, '19.

Stephen Powers

Okay. Great. And then back to Nik's question on US Wet Shave, can you talk a little bit more about what you are or aren't seeing now that Gillette's price pack architecture change has begun to flow into the market? I know that previously you'd said you really weren't expecting much in the way of kind of

net change post this implementation, just given the promotional rates that were running coming into it. But I'm curious if that view has evolved at all now that it's begun to flow into the market.

David Hatfield

Yes. It is early days still. So, we see a lot; there's a lot that needs to settle down. So, I'm not sure that we have a very definitive answer to that.

Maybe to break it down, there's kind of three facets to their program. One was that they went to what we call one-ups, which are packages that have the handle plus one cartridge rather than the normal two. So, they've downsized, and they also launched some two-pack refills. Those are measures they've done in the past and frankly didn't work or didn't help the category. We're seeing those reverse pretty quickly, and I think the customers will actually move away from those pretty quick. So, that should go away.

Secondly, in the majority of the cases, what we're seeing are promotion levels, rollback levels that are now being made permanent. There, again, we don't see that as a real incremental impact to us. There is a third category that may be emerging with some brands where the price cuts may be deeper than the promoted prices that we've been seeing. So, there may be some incrementality there. I think, it's too early to really gauge that, but we'll monitor the situation.

Stephen Powers

Thank you.

Chris Gough

Thank you, Steve. Operator, next question please.

Operator

Our next question comes from Wendy Nicholson with Citi. Please go ahead.

Wendy Nicholson

Hi. Two questions. Just first of all, on the Tmall launch, can you talk just—I know, it's early days, but how your product is priced on how much promotion you're doing, and sort of how big are your expectations for that business in terms of how quickly do you think it will ramp up?

And then, second of all, just kind of higher level on the Fem Care business, I know there are a lot of things affecting the results in the quarter, but the conversation about category weakness surprises me because that strikes me as a category where you probably don't have a huge amount of inventory at home, so there shouldn't be a lot of destocking. People use it kind of regularly. There are no trends like people aren't shaving or casual Fridays or whatever that should be affecting the category. So, could you just offer your take on what is leading to underlying volume weakness in a category like Fem Care? Thanks.

David Hatfield

Yes. Yes. Thank you. On the Fem Care question, we don't have any real deep insight there. I'm sort of chalking it up to the fact that almost every category within CPG land it was softer during this quarter. And where we've been seeing growth in the 1% to 2 %, it was actually down for the quarter. And I kind of chalk it up to the same trends that we see in other CPG categories, so I see it coming back.

In terms of China, it's early days with Tmall and there's a lot of work you have to do, but we're up running, learning, gaining insights. And in China overall, we see there's a pretty large opportunity, particularly for premium products through digital channels. We have around an eight share, and our

product lines have been skewed to the low end, and we're very under-indexed to a digital.

So, we see this as a great way to expand both penetration in the marketplace to consumers, also to augment our product line over time. So, we see this as a pretty sizable opportunity. But China, as a rule, we're not going to get too far ahead of ourselves from an investment point of view. I think, as we grow, we'll continue to invest.

Wendy Nicholson

Got it. And just back on the Fem Care side, do you see any disproportionate shift in that category specifically from traditional retail to online channels?

David Hatfield

No. That's certainly growing, but it's not—I don't think that it over-indexes at all.

Wendy Nicholson

Got it. Terrific. Thank you so much.

David Hatfield

Thank you.

Chris Gough.

Thank you, Wendy. Operator, next question please.

Operator

Our next question comes from Ali Dibadj with Bernstein. Please go ahead.

Ali Dibadj

Hi, guys, a couple things. One is still on Wet Shave. It certainly seems like your competitor is, and Gillette is doing a lot of—excuse me—a lot of activity. They're changing pack sizes. They're changing price points. They're promoting more. And it doesn't really seem to be, so far, playing out.

Even in the Nielsen data today, looks like you guys are still maintaining share, in fact, gaining share in disposables. It doesn't seem like you guys are doing much, which I guess, is a testament to your brand and to your product. But do you anticipate doing anything in reaction because there's a lot of activity going on from them and not a lot of activity going on from you guys? That's my first question.

Number two is just on SG&A, it still seems very high. I understand that there are some investments here. But we haven't seen anything from ZBS flow through. It sounds like, Sandy, from your comments, it's going to come through over the next few quarters, but all we do see is lower ad spend, we see higher restructuring charges, but not higher savings as well. So, I'm just trying to understand about the direction from a cost savings perspective what we should expect.

David Hatfield

Maybe I'll begin with the competitive question, and then I'll hand over to Sandy. I think we're doing a fair amount from an innovation point of view and a brand and marketing point of view. And I think that's helping baseline shares. We'll continue to promote as we see kind of complements our baseline business.

In terms of reacting to competition, we're going to monitor it. But we prefer to build the business through innovation and it's worked for the last eight quarters and we'll keep with our game plan, but we'll monitor it.

Sandy, on the ZBS question?

Sandy Sheldon

Right. So, we did have higher SG&A this quarter and again largely due to investments in some of our growth initiatives, including China e-commerce and the program management costs behind ZBS. As we move into the second half of the year, we do expect to see better ZBS savings flow through and fewer costs, netting those savings down. So, we do anticipate we'll see some improvement in the back half. And I will say that we mentioned we did have some net savings in the quarter, some of that's SG&A, but we also had some part of that that impacted A&P as well. So, some of our agency cost-reduction initiatives were beginning to impact A&P as well this quarter.

Ali Dibadj

Okay. If I could just throw one last one in just in terms of your share buyback discipline, we haven't seen much of it. And certainly, your cash flows right now maybe don't allow it quite as much, but how should we think about your buyback discipline and your view obviously on where the stock is right now relative to that? Thanks.

David Hatfield

Yes. As we've said, one of our value drivers is to convert operating profit and to grow cash. And our priority is then of use of cash is, first, to put it back into the business to fuel growth opportunities and the cost takeout. The second priority would be opportunistic disciplined M&A. And then the third would actually be buybacks, and those remain our priorities. On a shorter-term basis, we look to balance capital allocation decisions like share repurchase against investment in the business, leverage ratios and available liquidity. And that's what we continue to do.

Chris Gough

Thank you, Ali. Operator, next question please?

Operator

Our next question comes from Olivia Tong with Bank of America. Please go ahead.

Olivia Tong

Thanks. I was wondering if you could provide a little bit more detail on your outlook for operating margin expansion, that's 50 basis points. Given that since you last flashed that guidance, Gillette has obviously announced its plans, and you've announced your direct-to-consumer initiative. Maybe your direct-to-consumer initiative was already factored into your outlook. But your savings targets haven't changed. So, can you talk about other offsets, or are your spending plans unchanged versus where you originally issued that outlook? Thanks.

Sandy Sheldon

Yes. So, we do continue to target our operating margin to expand about 50 basis points. Certainly the components of that change and move a little bit as we go through the year. But overall, they are going to be driven by the ZBS savings initiatives we've talked about, some of our productivity initiatives within cost of sales and gross margin, as well as some of our ongoing pricing and promotional spending plans.

So, those are probably the most key components of that expansion.

Olivia Tong

Got it. And then I guess two clarifications and then a follow-up. First, I guess, why shouldn't we expect

you to have at least allocate a bit more spending or give yourself a little bit more flexibility in terms of the either advertising, promotion, anything else to given sort of the unknowns in the second half? And then following-up on that, can you provide any additional color on your direct-to-consumer plans?

David Hatfield

Sure. I think, we're pretty comfortable right now based on what we see and what we know with our marketing plans for the balance of the year. Generally, those aren't things that you want to change within two, three, four months. You want to work with your customers and make sure that it's planful and it's productive from a category point of view. So, generally, we're actually comfortable with our plans.

Now, we'll certainly monitor what's going on and we build contingencies and all that kind of thing, but right now, we're actually pretty comfortable working the plan. I forgot, what the—

Sandy Sheldon

DTC.

David Hatfield

Yes. DTC, it's been our observation that at CPG companies and brands that merely replicate their brick-and-mortar approach and put it online, they have not fared very well for the effort and the bother.

We've been working to come up with a proposition that's more unique, that's differentiated and it's taken some time to do so, but we think that we're getting pretty ready to be able to launch that in the US. And I see us learning from that, building that out, and then rolling that out in other markets and then maybe replicating it with a different brand. So, we'll see. We'll learn from it and roll it out.

Chris Gough

Thank you, Olivia. Operator, next question please.

Operator

Our next question comes from Jason English with Goldman Sachs. Please go ahead.

Jason English

Hi, guys. Thanks for slotting me in here, appreciate it. I want to come back—I guess, let's come back to US Wet Shave, men's Wet Shave because it's obviously the topic du jour right now. The comments, it's kind of steady as she goes, yes, it's been tough but not a whole lot is changing. Obviously, a little incongruent with P&G's rhetoric and a little incongruent with the data too, particularly if we look at systems right now. And there's a lot of noise in the Nielsen data, but when we do, it shows some pretty aggressive sequential pricing actions that you guys may have taken here with prices sort of latest 12—down almost 8% from the 12 weeks, kind of where we wrapped up 2016.

Can you give us some more color on what's going on there? Is this timing related? Is it mix related or are you also sort of taking corrective actions on your price points in systems?

David Hatfield

No. From our side, that'd be timing of customer programs, promotions, that kind of thing. So, there's not a systematic change. I know of several programs that are underway right now that probably weren't a year ago. But, overall, there's not a systematic change. That said we'll monitor the situation and change if needed.

Jason English

Okay. That's helpful. And one more follow-up, also on the category, but aggregate US growth, correct me if I heard it wrong, but I think you said men's manual shave down 12%, and track data down 4% when you incorporate online and all the unmeasured channels. The 800 basis point spread is big. It's a lot bigger than when you guys gave your Analyst Day, and I think, you highlighted around a 240 basis point spread.

So it suggests that online has accelerated rapidly, is far, far bigger than it was at this point in time. Yet you're saying things like DTC are actually slowing. So, how do we foot all that? And can you give us your best sense of what online share of the category is today and what its growth rate is?

David Hatfield

Okay. Sure. I think, this quarter, DTC really, it was up. And unmeasured is about 26% of the market and was up, we estimate, about 7%, which is lower than it's been in other quarters. But the brick-and-mortar market was really down. When you look at men's, for example, the overall trend has been, for measured now, units have been down over the last year or so by about 4%. This last quarter, they were down about another point. I'd sort of say that's similar to other CPG categories where it was just a soft quarter.

But then there was a gap, but revenue was down six or seven points more than that. And I think that reflects competitive promotion levels. Also, we've had high although pretty flat versus year ago. So, I think that that value gap really reflects competitive promotion in the market, and that's how I'd analyze it.

Jason English

Okay. Thank you. I'll pass it on.

Chris Gough

Thank you, Jason. Operator, next question please.

Operator

Our next question comes from Faiza Alwy with Deutsche Bank. Please go ahead.

Faiza Alwy

Yes. Hi, good morning. So, I just wanted to check on your gross margin outlook for the year. Has that changed at all? And then, just back to the Wet Shave category, what is your view on the category outlook? I know that previously you had mentioned that the category should increase 2% to 3% and you expect to grow in line with the category. So, clearly, it softened. So if you have any updated views on the category that would be helpful. Thanks.

David Hatfield

Okay. So, maybe, Sandy, would you want to comment on the gross margin?

Sandy Sheldon

Yes. So, on gross margin, for the year we're really focusing on driving our operating margin expansion of 50 basis points. And so, really, within that we're maintaining some flexibility within gross margin, SG&A and A&P, and not really putting out specific targets, given that it could really vary depending on our top-line trends, the level of investment back into the business and the competitive environment. So, overall, we're really, really more focused on the operating margin expansion and working all levers that we have to ensure that we meet that.

David Hatfield

And then, on the category, when you look globally, we were looking at kind of low-single-digits, call it 2% or so, and I think that that softened, primarily US-driven, also a few European markets that softened from a trend point of view. And right now, at least through the fiscal year, we see that continuing. So we've seen global market more like flat, and we don't see that changing for the next few quarters.

Faiza Alwy

And just to follow up on that, so do you expect to maintain shares, so do you expect your organic growth to be roughly flat also?

David Hatfield.

Yes, maybe up a little bit. Our track record and our algorithm looks to modestly grow share, and we think that we can continue to do that internationally and in the US in the women's and in disposable.

Faiza Alwy

Okay. Thank you.

Chris Gough

Thank you, Faiza. Operator, next question, please.

Operator

The next question comes from Kate Grafstein with Barclays. Please go ahead.

Kate Grafstein

Thanks. I just wanted to ask a question on Fem Care margins. So, I thought that by moving to the new manufacturing facility, this would improve margins over time. And I just wanted to ask, are transition issues greater than you had expected, and over time what's the appropriate margin structure for this business once issues are worked through? Thanks.

David Hatfield

Yes, I'll actually begin then I'll ask Sandy to give some color. But, yes, this has been a pretty mammoth transition. I think, the team is working really hard. But this is a particularly tough quarter for us as we're winding down the Montreal plant, but we're still there and we're on the ramp-up learning curve in the Dover plant. So, we're kind of getting the worst of both worlds, and I characterize this as probably the toughest quarter from a transition point of view. I think, it's taken about a quarter longer than we thought. I think, we're making progress, and I expect that we're running better and that the cost position gets better from here on.

Sandy Sheldon

Yes. So, the only additional color I'd say is we do anticipate some additional transition costs through Q3, and then, with improvements beginning in Q4 and then into 2018. I think, we would expect to be able to see low teens—be able to return to low-teen margin structure sometime within fiscal year 2018 into 2019.

Chris Gough

Thank you, Kate. Operator, next question please?

Operator

Our next question comes from Bill Chappell with SunTrust. Please go ahead.

Bill Chappell

Thanks. Good morning. And maybe I missed it, kind of thoughts on Fem Care over the next two, three quarters? Is there expectations for things to improve as a category, and kind of what have you seen in April as we've continued to move into the next quarter?

David Hatfield

I can't really comment about April. I haven't really seen that data. But, I think, we do think that the category will come back to modest growth. I think, it was a little bit of an anomaly. I don't know if it will be—if it will come back next quarter or the one after that, but I think that it should return to growth.

And then we're going to focus on really stabilizing sales going into 2018 through a focus on the category management, innovation, and the marketing fundamentals. But the trump goal, as we've said, is to increase profitability, and as we talked about trying, consolidating operations in the Dover plant and then running better down there.

Bill Chappell

Okay. And then can you just remind me on the Dover plant—I mean, I remember we started the year with the expectation or maybe we started that it will be closed a lot sooner and then you would recognize the benefits this year. So, could you just remind me kind of what the savings are, and I assume that would all be reflected in fiscal '18?

David Hatfield

Yes. I think, we're running about a quarter or so behind. And we thought that we would have it done this fiscal, and I think that it may bleed into next year by a quarter.

Sandy, do you have the savings?

Sandy Sheldon

Yes. So, we are seeing some savings this year on the Fem Care part of it. Obviously, we've got other savings in restructuring, right, that we're tracking against this year, including our Wet Shave footprints move and some of our Sun Care in-sourcing activities that have been doing well. But we're also seeing some savings just as we ramp down the Montreal production site. It's just the majority of them we'll start to see in Q4 and then into '18 and '19.

Chris Gough

Thank you, Bill. Operator, next question, please.

Operator

Our next question comes from Kevin Grundy with Jefferies. Please go ahead.

Kevin Grundy

Thanks. Good morning, guys. Question on the growth opportunities that were outlined in your press release this morning, so, specifically international expansion, Sun and Skin Care, and e-commerce. So, a few questions related to that.

David, perhaps you can talk about the role of organic investment versus M&A, which businesses and regions you're most focused on for international expansion? You mentioned China earlier in the call.

And then, there's been some discussions, Sandy, around margin implications. So, understanding you guys are comfortable with the 50 basis points for this year, and, in addition, you guys also called out the 50 basis points just for your long-term algorithm. So, my question on the margin component is not so much '17 but looking out beyond '17. Is that still the right margin algorithm for the company? Thanks.

David Hatfield

Thank you. From an investment point of view, I mean, certainly China, but I mean, generally, international and the emerging markets in Asia and in LatAm are our focuses for continued growth.

Sandy Sheldon

Yes. So, on the margin implications, I guess, sort of over the medium to long term, we do still see that as the right metric for us to include in our algorithm. And some of the drivers of that remain the same as they've always been, which is continuous improvement against our cost base, both in a production and a non-production perspective, ongoing work on marketing mix, ongoing work on trade promotion efficiency, ongoing zero-based budgeting and spending initiatives and focus.

So, we see several paths to continuing to improve our operating profit margin even with some of these. And I presume your question suggests that some of the opportunities are lower margin. And you're right, some of them are. But we really do see the ability to improve against our cost base and improve against even some of our spending categories as well to ensure they're as optimal and productive as possible.

Kevin Grundy

Okay.

David Hatfield

And I might jump back in because I didn't answer your question about M&A. And we actually view that as opportunistic and we're looking at the top of the funnel with several targets at any given time. I guess, we have a little bit of a bias internationally just because of the cash that we're holding there. But we generally look at targets anywhere, and so, we're active there looking mainly in the Skin Care, the men's grooming categories, adjacencies that are pretty close to where we're at with Shave or Sun and Skin.

Kevin Grundy

Okay. Thanks. And then quick follow-up, just on the top-line algorithms, so David, it's now flattish relative to the long-term algorithm of the 2% to 3%, so for the foreseeable future it's sort of flat top line for the entire company. Is that correct?

David Hatfield

No. No. We think given innovation that we're looking at over the next several years, plus the growth opportunities that we see, the full portfolio, etc., we think that we have line of sight to the 2% to 3% algorithm over the medium term.

Kevin Grundy

Very good. Thank you and good luck.

David Hatfield

Thank you, Kevin. Operator, next question please.

Operator

At this time, I'm showing no further questions. So, I would like to turn the conference back to David Hatfield for any closing remarks.

CONCLUSION

David Hatfield

Only that I thank you all for your time and your interest. Thank you, all, and have a nice day.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.