Edgewell Personal Care Company

Fourth Quarter Fiscal 2016 Earnings Conference Call

November 10, 2016 at 10:00 a.m. Eastern

CORPORATE PARTICIPANTS

David Hatfield, President and Chief Executive Officer and Chairman of the Board

Sandy Sheldon, *Chief Financial Officer*

Chris Gough, *Vice President, Investor Relations*

PRESENTATION

Operator
Good morning and welcome to the Edgewell Fourth Quarter Earnings 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 1 on your telephone keypad. To withdraw your question, please press star, then 2. 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, Kate. Good morning, everyone, and thank you for joining us for Edgewell's Fourth Quarter Fiscal 2016 Earnings Conference Call. As a reminder, for comparative purposes, fiscal 2015 full year results include both the Personal Care and the Household Products businesses, with the results of the Household Products business presented in discontinued operations.

Historical results on a continuing-operations basis in fiscal 2015 include certain costs associated with supporting the operations of the household business as these costs were not reported in discontinued operations. As a result, full-year fiscal year EPS is not comparable to the prior year as the prior year's results include SG&A expense, interest expense, spend costs, restructuring costs, and tax associated with supporting the Household business. Additionally, EPS was not comparable in either the first, second, or third quarters of fiscal 2016. To partially address this, we have provided normalized fiscal 2015 EBITDA, reflecting proforma adjustments to SG&A. You will find these normalizations in the non-GAAP reconciliations at the back of the press release issued earlier today and on our website.

With me this morning are David Hatfield, our President and Chief Executive Officer and Chairman of the Board, and Sandy Sheldon, our Chief Financial Officer. David will kick off the call, then hand it over to Sandy for the earnings and outlook discussion, followed by Q&A. This call is being recorded and will be available for replay via our website.

During the call, we may make certain statements about our expectations for future plans and performance. This might include future sales, earnings, advertising and promotional spending, product launches, the impact of go-to-market changes on sales, 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, 2015 as amended and supplemented in our quarterly reports on Form 10-Q for the quarters ended December 31, 2015, March 31, 2016, and June 30, 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. The 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, www.edgewell.com. Management believes these non-GAAP measures provide investors with valuable information on the underlying trends of business.

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

David Hatfield
Thanks, Chris, and good morning, everyone. Before Sandy takes you through the results, I'll briefly comment on a few highlights of Edgewell's performance for the full fiscal year and a comment on our outlook for fiscal '17. We're pleased with our fiscal '16 results, which were in line with the plans that we set for ourselves at the beginning of the year, and we're particularly pleased with the topline performance for the year. Full year organic net sales grew 1.4 percent, and underlying sales growth, excluding the impact of our go-to-market changes, exceeded our expectations at 2.8 percent.

Let me spend a few minutes on the drivers of that growth. As we indicated at our Investor Day back in June of 2015, the 2016 fiscal year was going to be a transition year and a year where we would focus on four main business priorities to accelerate topline growth. Our first priority, to complete go-to-market and functional realignment initiatives around the globe was completed in the third quarter. The impact in the year was within expectations, and the new structure and distributor relationships are working well. Our second priority was to execute against our segment plans and to grow underlying sales in wet shave and sun. For the year, wet shave organic net sales were up 1.8 percent, and sun and skin organic net sales were up 4.6 percent. That's solid progress in these two key segments.

Within Wet Shave, we're benefiting from our next generation hydro product improvement and strong private label sales, including the recently introduced Fits Mach3 private-label product launched in partnership with our U.S. customers. We've also grown women's systems and shave preps this fiscal year behind innovation and category management. Third, we had to solidify and return to growth in North America. For the year, organic net sales in North America grew nearly 2 percent, driven by growth in wet shave and sun and skin. And our fourth priority was to continue our momentum internationally. For the year, international organic net sales were up 1.1 percent, and that included nearly 4 points of impact from go-to-market changes, so another solid year from our international team.

Now, turning to bottom line results, we achieved our outlook for adjusted earnings per share while managing through very complex go-to-market and other structural changes that I discussed. Importantly, we were able to invest back into the business with A&P and R&D spends that finished the year within our target ranges, and we invested in our strategic growth projects including e-commerce, IT infrastructure, and emerging markets, all of which fell into SG&A. We also delivered on other elements of our strategic value drivers. For example, we recently acquired Bulldog, a great new men's skincare company out of the U.K. We're very excited about the prospects for that business. And we repurchased over 2.5 million shares for the fiscal year.

Now, although we achieved many of our goals for the year, we have more work to do in other areas. Our femcare business remains a point of focus as we work to maintain sales and complete the consolidation of manufacturing to our Dover plant. Our overall SG&A spending remains higher than target, and although much of that reflects the increased strategic investment, we're working on a number of key initiatives to help us address this issue. The competitive environment remains very intense, and we need to continue to act with speed and agility.

So as we look towards 2017, it's the same five value drivers and key priorities that will generate top and bottom line growth. Our first value driver to accelerate topline growth will rely on our ongoing momentum in the wet shave business, driven by further growth in international, growth through innovation across the full portfolio, and aggressively adding to our capabilities in the growth channels, such as e-commerce and emerging markets. In sun and skin care, we'll drive growth through category growth and continued international expansion including the new Bulldog acquisition. And in femcare, we'll maintain topline sales through new innovation and investment in growth brands, while focusing on cost savings to enhance profitability as we look to fiscal '18. Of course, across all the segments, we need to monitor macro-economic conditions and keep a close watch on the competitive environment, but based on what we see today, our outlook is for low single-digit sales growth for fiscal '17.

Turning to our second value driver, systematic cost reduction, we'll leverage productivity initiatives including ongoing restructuring savings in fiscal '17 and beyond. Our ZBS initiative is already yielding results, with more to come, and our trade management optimization initiative is producing results in North America. These projects fit well into our culture of systematic cost reduction and will increase our operational and financial flexibility in 2017 to further enable our growth objectives and to drive margin expansion, and we expect to generate at least 50 basis points of adjusted operating margin expansion for the full fiscal year.

Our third value driver, free cash flow generation, comes from a combination of topline growth, operating margin expansion, and working capital improvements. And like we did this past year, we expect to achieve our free cash flow target of over 100 percent of net earnings for fiscal '17. And we'll continue to take a disciplined and active approach to M&A, which is our forth value driver.

So overall, we're encouraged as we enter fiscal '17. Our outlook is for growth on both the top and the bottom line, growth that is in line with our longer-term algorithm.

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

Sandy Sheldon
Thank you, David, and good morning, everyone. Let me take you through the specifics for the quarter and highlights for the year.

Net sales in the quarter were $611 million, an increase of $51 million, or 9 percent, driven by growth in all four segments and all key geographic regions. North America net sales were up 8.4 percent, with growth across all segments. International net sales increased 14.2 percent, or 11 percent on an organic basis, driven by growth in wet shave and sun and skin care. Gross margin was 51 percent of net sales, up 270 basis points over the prior year. The increase was primarily due to lower promotional spend and lower material costs, which were partially offset by higher start-up costs related to the femcare production consolidation into our U.S. plant. A&P expense was $82.6 million in the quarter, or about 13½ percent of net sales, which represents a more normal level compared to relatively higher spend of 17 percent in Q4 of ’15. SG&A was 17.7 percent of net sales, including $3.6 million of intangible amortization. Excluding $30 million in prior year charges related to the spinoff of the company’s Household Products business, SG&A increased 100 basis points over the prior-year quarter. This increase was driven by higher spending and strategic growth projects, IT projects, and higher corporate costs as well as increased compensation expense, including incentive compensation.

Other expense net was an expensive $2 million during the quarter compared to income of $3½ million in the prior year quarter. This change was largely driven by foreign currency hedging contract losses, particularly related to the Japanese yen and revaluation losses on non-functional currency balance sheet exposures.

Net earnings in the quarter were $52.2 million compared to a net loss of $219 million in the fourth quarter of fiscal ’15. The increase in earnings was primarily related to the intangibles impairment charge and higher costs related to the spinoff in the prior year quarter and to higher segment profit and operating margin expansion this quarter.

Fourth quarter adjusted EBITDA was $119.4 million, an increase of $36.4 million versus fourth quarter of ’15. Cap-diluted EPS was 88 cents in the quarter as compared to a loss of $3.57 in the prior year. Adjusted EPS for the quarter was $1.06 compared to 64 cents in the prior year.

So now to move on to fourth quarter segment results, wet shave organic net sales increased 7.4 percent, with growth across systems and shave preps. Planned lower promotional spend in North America from lower coupons and trade spend, was the largest driver of the sales increase, followed by Hydro sales growth in Asia, women’s systems globally, and Hydro Silk in international.

A quick comment on the level of coupons and trade spend in the current quarter. We knew coming into the year that this would be a driver in the quarter, given the high level of spending a year ago. The level of promotional spend this quarter was actually slightly higher than our historical trends but significantly lower than last year. Organic wet shave segment profit improved by $31 million due to lower promotional levels as well as lower product costs and modestly lower A&P spend.

As measured by Nielsen, the U.S. manual shave category was down over 5 percent in the latest 12-week data, with declines in men’s systems and disposables. Men’s manual shave was down 6 percent; however, when factoring in non-measured channels, we believe the U.S. men’s category was off 2 percent and the overall category was down about 2 percent due to men's and disposal stock xAOC.

From a share perspective globally, we're competing well, gaining share in several non-U.S. markets as well as gaining share in the U.S. Versus a year ago, our U.S. share was up 50 basis points in manual shave, driven by market share gains in men's. Note that our U.S. corporate branded share results continue to be impacted by a transition of our opening price point value-branded product offering in a major retailer to a private-label product line.

Sun and skin care organic net sales increased 18 percent in the quarter, with growth in both Banana Boat and Hawaiian Tropic and across North America and international. This sales growth was largely volume based and in line with the U.S. category growth, which was stronger than anticipated due to favorable weather trends as well as category share and distribution gains across international.

Organic segment profit improved approximately $10 million in the quarter, driven by higher sales volumes, lower product costs, and lower A&P spend. Within the U.S. category, consumption was up about 9 percent in the quarter and up 4 percent in the latest 52-week data due to favorable weather over the peak summer season. Market shares across both brands were down slightly for the 12-week period, though both held share for the 52-week period.

Feminine care organic net sales increased $11 million, or 11.4 percent, with lower promotional spending compared to very high spend levels last Q4, partially offset by lower volumes. Segment profit declined approximately $1 million despite the increase in net sales, due primarily to higher production costs and start-up costs associated with the consolidation of manufacturing into our U.S. plant.

Now, a few highlights on the full year results. Net sales decreased 2.4 percent but increased 1.4 percent on an organic basis, which included a 140 basis point impact from international go-to-market changes that were completed in the third quarter. North American net sales increased 1.7 percent for the full year, and international organic net sales increased 1.1 percent, or 5 percent on an underlying basis. Gross margin was 49.1 percent of net sales, roughly in line with the prior year. Full year A&P expense was 14.3 percent of net sales, down versus the prior year spending at 15.2, but in line with the company's target range. SG&A expense was $413 million, including $14.4 million of intangible amortization. Excluding the impact of $12 million in spend-related costs, SG&A was $401 million, or 17 percent of net sales. Other expense net was an expense of $3 million compared to income of $12 million in the prior year, largely reflecting the same drivers as in the quarter.

On a segment level, wet shave organic net sales was up nearly 2 points for the year, driven by lower promotional spending, strong global Hydro sales, and strong private-label sales in North America. This growth included an estimated $29 million of go-to-market impacts for the year. Sun and skin care organic net sales were up 5 percent, mirroring the quarter, with growth in both product lines and across all regions. Finally, organic net sales in feminine care were down 1.8 percent, largely driven by declines in pads, partially offset by increased sales in tampons and liners.

For the full year, organic segment profit was up $12.3 million, driven by strong profit performance in sun and skin care and infant, both due to improved product costs, lower A&P, and improved volumes in sun and skin. These gains were partially offset by wet shave organic summer profit, which declined 2.6 percent due to higher overhead costs and product costs, partially offset by lower A&P and promotional activity. Feminine care organic segment profit declined approximately 16 percent due to unfavorable product costs related to start-up expenses and unfavorable transactional FX, partially offset by lower A&P.

Overall, at the total company level for fiscal ’16, adjusted EBITDA was $440 million versus fiscal 2015 normalized adjusted EBITDA of $462 million. Although segment profit was up year over year, this growth was offset by $7 million of unfavorable foreign currency movements, $11.6 million from the impact of Venezuela and industrial, and another $15 million in other expense net described previously.

GAAP-diluted EPS was $2.99 as compared to a loss of $4.44 in fiscal ’15, and adjusted EPS for the year was $3.57 compared to $2.80 in the prior year. Net cash from operating activities was $176 million, and free cash flow was $107 million for the full year. This includes a discretionary contribution of $100 million we made to one of our international pension plans, which negatively impacted cash flow for the year. Adjusted working capital as a percent of net sales improved to 16.1 percent at the end of the fourth quarter versus 17.5 percent at September 30, 2015. The 140 basis point improvement was driven by lower days payable outstanding and improved days in inventory. Adjusted working capital continues to reflect a higher level of inventory in feminine care, which is expected to return to normal levels as we complete the consolidation of manufacturing during fiscal year 2017.

In terms of capital allocation, we repurchased 2.5 million shares for approximately $197 million. Subsequent to year end, we paid down international debt by $277 million and acquired Bulldog Skincare. Both of these transactions were completed with international cash.

In summary, we ended the year with solid fourth quarter results on both top and bottom line. We returned significant capital to shareholders and managed through complex transition issues in line with the goals we set for the year.

Now, I’d like to turn to our outlook for fiscal 2017. For fiscal ’17, we’re aligning our full year outlook metrics with the company’s long-term financial algorithm metrics, which are net sales growth, operating margin expansion, and earnings per share growth. We estimate that net sales will increase by low single digits, with no expected impact from currency based on recent exchange rates, although, as everyone knows, currency rates remain very volatile. The topline outlook includes an estimated 40 basis point benefit from the Bulldog acquisition, which represents 11 months of activity.

The GAAP EPS outlook is $3.60 to $3.80, and adjusted EPS is estimated to be in the range of $3.80 to $4.00. The impact from the acquisition of Bulldog is expected to be neutral to EPS in ’17. The effective tax rate for the fiscal year is estimated to be in the range of 27 to 28 percent. Adjusted operating income margin is anticipated to expand by at least 50 basis points. Based on our current view, we anticipate this margin expansion will be driven by gross margin improvement and lower SG&A as a percent of net sales, slightly offset by higher A&P spend as a percent of net sales.

The full year estimate for restructuring-related costs is $15 [million] to $20 million for fiscal ’17. Incremental restructuring savings are expected to be approximately $20 [million] to $25 million in ’17, with an additional $25 million in fiscal ’18. In terms of overall quarterly phasing for fiscal ’17, we anticipate that sales and earnings growth will not be uninform by quarter, largely driven by timing of product launches and A&P spend. In particular, in the first quarter, net sales are expected to be relatively flat, and segment profit is anticipated to be moderately lower than in the prior year quarter.

Let me wrap up by addressing Zero-Based Spend Initiative announced last quarter. The project is progressing well, and on a very preliminary view, we have estimated we can deliver $35 [million] to $45 million in net savings over the next two years. Savings will begin in the back half of fiscal 2017, and our current outlook incorporates a preliminary net savings estimate for $10 [million] to $15 million in fiscal ’17.

As David mentioned in his upfront comments, SG&A as a percent of net sales will remain a high focus item for the company. We are committed to lowering SG&A as a percent of sales but are also investing in strategic areas to generate and accelerate topline growth. The ZBS initiative, along with our other productivity initiatives, is designed to give us the flexibility to achieve both of those goals, providing ongoing financial and operational flexibility for reinvestment and reinforcing growth in our financial algorithm.

Thank you, and, with that, we will 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 1 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 2. At this time, we will pause momentarily to assemble our roster.

The first question comes from Wendy Nicholson of Citi Research. Please go ahead.

Wendy Nicholson
Hi, good morning. Two questions, if I can. First, as you look towards next year and your topline forecast, I know you don’t give specific guidance by segment, but would you still expect skin care to be the fastest growth segment among the three? And then, secondarily, can you just run through exactly what’s driving the target for gross margin expansion? Is that a continuation of some favorable commodities, is it more favorable product or mix shift, or what’s driving that? Thanks.

David Hatfield
Okay. Great. Thanks, Wendy. First, you know, the first question, for our topline next year, we see wet shave continuing to grow in line with market, say, 2 to 3 [percent], and we see sun and skin also growing 3 to 4 [percent], let's say. And then maybe if I could hand it over to Sandy.

Sandy Sheldon
Right. On the gross margin question, Wendy, yes, you're right. We are continuing to see favorable commodity prices. Obviously, we'll have restructuring savings that roll through our gross margin, and we'll also benefit from some improved price mix in the year.

Wendy Nicholson
Got it. And back on that segment growth, on wet shave in particular, are you expecting a continuation of your market share gains? It sounds like your shift on the opening price point product has been really successful. Are you expecting any other changes strategically with any major customers, anything like that**?**

David Hatfield
No, it's really based on our continued focus on building baseline share through sales, baseline sales through innovation behind driving innovation, focusing on building equity, leveraging the full portfolio all the way from Hydro down through private label and then continued international growth. Given the promotional headwinds, I think we're looking at growing within the line to market growth.

Wendy Nicholson
Got it.

Chris Gough
Thank you, Wendy. Operator, next question, please.

Operator
The next question is from Nik Modi of RBC Capital Markets. Please go ahead.

Nik Modi
Yes. Thanks. Good morning, everyone. Just a quick clarification. The zero-based budgeting savings and the restructuring savings are separate, right? So you basically add the two together? I was just unclear on the wording in the press release on if those are two separate items or you were just including all the savings together. So that was the first clarification. And just talking about zero-based budgeting in general, David, do you feel like the organization is ready, culturally, for something like this? Because that, obviously, is the key on really having a successful program, as we've seen from some of the other companies that have tried to do this. And then the second question is just on M&A. You've obviously done a bolt-on. Just curious what you think of the environment, generally, for other potential bolt-ons. Thanks.

David Hatfield
So maybe the first question, Sandy, if you could handle it, then I'll —

Sandy Sheldon
Yes. Nik, those are two separate sets of savings. They're not — yes, they're two separate sets.

David Hatfield
Right.

Nik Modi
Great.

David Hatfield
Then it's a good question about ZBS and the culture, and I actually think that we are. I think part of the timing and the reason that it's taking some time to get it finalized and all is we've taken a lot of time to set up the category owners, set up so that we can replicate it, that it's going to be part of our process and our DNA. If you go back into time over the last three or four years, we've actually focused a lot on cost and on productivity, so it's not a new theme, and I think that the organization understands. I think ZBS is bringing tools and a process to make it a living process, and I think the key, as we communicated to the organization, is partly to emphasize that we're doing this to generate flexibility, to put money back into the business, whether it's demand creation, whether it's better organizational capabilities, or it's generating profits to return to shareholders. And I think that the balanced goal there will help make it even more of a key linchpin in our culture.

Moving to your final question, we're actually pleased with our little bolt-on. I think it makes a lot of sense. The market out there is tight. There's not a lot of candidates. We're looking hard. I think price tends to be pretty high yet, still, but we're actively looking, and we're actively looking at similar kinds of bolt-ons.

Chris Gough
Thank you, Nik. Operator, next question, please.

Operator
The next question is from Jason English of Goldman Sachs. Please go ahead.

Jason English
Hey, good morning, guys. Thank you for the questioning. Congratulations on a strong finish to the year.

David Hatfield
Thank you, Jason.

Jason English
So it appears that, per your rhetoric, your private-label initiative has some great momentum. A question for clarification. Are you the only ones with the capability to do a Mach3 compatible blade out there right now?

David Hatfield

Oh, probably not, but I think we're unique in making a Fits Mach3 that actually shaves at a performance level that really makes it a viable value versus Mach3.

Jason English
And in terms of distribution or penetration of the accounts where you think this product can be sold, where do you stand right now?

David Hatfield
Within the U.S., it's been accepted everywhere that I know of. I think if you look just at Nielsen ACV, we're still only a 50 to 60 percent the last time that I looked, so there's more room to get facings, and that will be more of a process as we pass other reset times for customers, but we have broad-based acceptance.

Jason English
And the last question — I'll pass it on — in terms of the cadence of how that built through the year, is that distribution still going to be largely incremental as you come into the year, and when do you start to cycle it? And thank you for your time.

David Hatfield
Yes, good question. I think it's gradual. We'll anniversary it by March/April, I think.

Sandy Sheldon
I think it's closer to June.

David Hatfield
Well, okay, yeah, you're right. We didn't really begin, so June, and, as I mentioned, I think that it's building now, so —

Sandy Sheldon
It will be incremental the first half or so.

David Hatfield
Right. So figure that we'll really anniversary it maybe the middle to the end of next year. Thank you, Jason.

Jason English
Helpful stuff. Thanks, guys.

Chris Gough
Thanks, Jason. Operator, next question, please.

Operator
The next question is from Bill Chappell of SunTrust. Please go ahead.

Stephanie

Hi, this is actually Stephanie on for Bill. Maybe this goes off a little bit of Jason's question — could you give the drivers of the flat first quarter growth outlook, what should we be looking for like from a year-over-year standpoint? Thanks.

David Hatfield
So the question is — okay, from Q1, I think there's a couple of things maybe. We're actually comping a fairly solid year before, and we're entering it with a little bit less promotional weight than we were last year, and I could see a little bit of softness maybe on the disposable front.

Chris Gough
Thank you, Stephanie. Operator, next question, please.

Operator
The next question is from Ali Dibadj of Bernstein. Please go ahead.

Ali Dibadj
Hi, guys. I've a couple, I think, straightforward ones. One is on the Mach3 lookalike. How do we think about the risk of patent infringements coming after you guys from a lawsuit perspective on Gillette? That's one. Two is on topline, even in the Nielsen numbers, if we give you everything we can from private label, so assuming you're everything on private label in all the growth, it's still way far away from 9 percent, so how do we think about any inventory loading that happened, or is it really coming from the untracked channels? And then on — well, that one's — can you please help us understand what you mean by strategic initiatives?

David Hatfield
Yes, okay, fair enough. On the Mach3 front, you might have seen the suit, but we're not worried about it. The Mach3 patents have expired, and so we're confident we have the freedom to operate. On the bridge for the quarter, wet shave was up 7 percent, and it was up like $26 million. International was up $16 million, almost 9 percent. It was up across all the areas and the segments. You move to the U.S., which was up 7.8 [percent], and, you're right, when you take Nielsen, I'll fill you in that when you add private label, total EPC Nielson consumption was down maybe 3 to 4 [percent].

Now, bridging that gap, that was all — the major, major difference was actually price mix, where the comp versus previous year versus coupons plus some trade promotion spending, that was the big difference. From a channel point of view, measured and unmeasured, we're generally in line, and I think the underlying shipments track pretty much the EPC consumption of it down 3 to 4 [percent], so I don't see much of a difference from a shipped consumption point of view.

And then what we were talking about with the initiatives, the world's changing, and through the year, we've been agile enough to move some money to try to build and accelerate capabilities in the digital and in the e-commerce, both in the U.S., but also China, and then some IT support and projects that also support working capital initiatives. And then ZBS also, I would tuck into there.

Chris Gough

Okay, thank you, Ali. Operator, next question, please.

Operator
The next question is from Olivia Tong of Bank of America Merrill Lynch. Please go ahead.

Olivia Tong
Thank you. I wanted to talk about the sustainability of growth. I know there's an easy comp in Q4, but your two-year stack saw a pretty big acceleration, so why doesn't more of the benefit of the growth that you saw in Q4 flow through to next year? Because it doesn't look like you're really expecting much for fiscal '17. And then in terms of the pullback relative on a year-over-year basis in promo and couponing, what does this say about the necessary levels of promotion and couponing to spur activity in your categories? Thanks.

David Hatfield
Yes, okay. All right. So the first part of that, last year's quarter was an anomaly, and so when you look at it —let's see, let me — international grew — the easiest way to say this is half or a little more than half of the sales growth versus a year ago was driven by lower couponing and promotion, so that gets us to 3 to 4 percent normalized growth. And that was driven by some underlying growth in the U.S., but a lot of growth internationally, where we were up in all geographies and in all segments, so it was a strong quarter gain share in the U.S. and in most major markets, but I wouldn't draw just a straight line from there on. It was a very good quarter and with competitive pressures and all, I wouldn't say that we could do that every quarter.

Your second question, I would just say do we have the right level going into next year? The quarter, this quarter was a pretty normal quarter. When you compare trade spend to the year average, it was comparable. It was higher than that of two and three years ago, so it's a pretty sizable level, and we're confident that it kicks us off in a good place.

Chris Gough
Thank you, Olivia. Operator, next question, please.

Operator
The next question is from Kevin Grundy of Jeffries. Please go ahead.

Kevin Grundy
Hey, thanks. Good morning. First question, Sandy, on going back to the ZBS and the restructuring, can you help us better understand the split of those savings from COGS and SG&A, where some of the savings are going? It seems like some two-thirds is going to be reinvested. How much of that goes to advertising and marketing? How much of that goes to other areas? And then where can SG&A go over time? Just beyond what you've currently outlined, how should we be thinking about where core SG&A can go? And then I have a follow-up. Thanks.

Sandy Sheldon
Okay. So on the restructuring savings, really, all of that goes into our gross margin and cost of goods sold line. From ZBS, I would say that project is looking at every line item and every cost

bucket, and so while I can't give you specifics on line items at this point, because we are still only about halfway through the project, I'll say it is likely we will see savings across every line item. So probably not as much in cost of goods sold, but we'll see it in — certainly in SG&A, we'll see it in R&D, we'll see some in some of our gross-to-net sales line items. So we are really looking at every cost bucket we have.

In terms of where it's going, I think David expressed it well at the beginning, which is this is a balanced plan and a balanced view of how we'll reinvest and look at the savings from ZBS, so some of them will be going up and reinvested back into gross to net, some of them will be reinvested back into A&P, and some of them will be reinvested back into SG&A to build capabilities, and, overall, we continue to focus on our financial algorithm of 50 basis points improvement. So some of them will go to shore that up as well.

Kevin Grundy
Okay. That's helpful. And the follow-up, for David, can you touch on Shave Club, both the risks and the opportunities there? And now we've seen Harry's move into Target, and they've had some success there, I think surprisingly so, probably both them and to the industry, I suspect. And clearly Unilever's placed a decent size bet on Dollar Shave, and I think collectively there will probably be a lack of surprise if we saw them move into retail at some point as well. And, seemingly, I understand you guys are participating, but I think there's still questions from your side in terms of the economic viability of the model despite the fact that, you know, it seems like enrollment continues to move up there and consumers are sort of willing to pay for the convenience, despite the fact that the efficacy is a bit lower, and, frankly, they're even spending more annually on the blades. But your updated thoughts there would be appreciated, given the growth that we're seeing there with enrollment. Thank you.

David Hatfield
Well, it's certainly a challenging area and a place where the world's changing, and certainly e-commerce, broadly speaking, around the world is a major issue, not only for us but for every CPG company, and we're working hard to really ramp up digital capabilities in the broad sense and beyond just the U.S., frankly. Within the U.S., when you look at e-commerce, when you look at the omnichannel and the pure-play channels, we've been powering up capabilities, putting a lot more resources against that, and we've gained share within those segments for each of the last three years. Now, when you talk about the shave clubs, the jury's out, and we can speculate where they'll morph. Sequentially, over the last two to three quarters, they've been pretty flat, not versus a year ago but a quarter to quarter to quarter. And with the challenge about profitability, I think you see them thinking about how to get their basket size up, become more than a shave club to really survive. So I think there's a question about how much aggregation needs to happen, so it's a question, and I'm not going to really speculate how much Unilever uses TSC as a shave club or an entryway to men's grooming or personal care, but that's, I think, the big question mark.

In terms of Harry's coming into Target, they've got good execution with an end cap and so, not surprisingly, generated a pretty good early trial. They got a sizable part of share in Target, and they've got about a 2 to 3 share of the systems nationally. I think we got hit with fair share or maybe a little less than fair share, so it's not a huge impact yet. We'll see how their trial converts to refills, and we'll see how their share moves once they go back to a more normal in-line set, and we'll see just how category profitability in that customer moves. As far as our plans there, they operate in a level where we have several options within our product mix, and we'll monitor them.

Chris Gough
Thank you, Kevin. Operator, next question, please.

Operator
The next question is from Bill Schmitz of Deutsche Bank. Please go ahead.

Bill Schmitz
Hi. I have two questions. So the first is just on the gross-to-net sales number. Can you tell us what like the gross-to-net was last year and what it was this year? And then bridge us to the gross margin year-over-year change, because it seems like a decent chunk of that gross margin expansion — and I get that it was just very elevated gross spending in the year ago, but it seems like a lot of that gross margin expansion was driven by that. And then just operationally, I think it would be really helpful for you guys to give us the split between volume and price mix. So would it be okay for you guys to give us that number this quarter, what volume growth was versus price mix? And then I have a follow-up, please.

Sandy Sheldon
So I'll jump in on a couple of the questions. Yes, Bill, you're right. The gross margin expansion for the quarter was largely driven by the lower promotional spend and the gross-to-net change. The volume — most of our sales increase this year —or this quarter, was the price mix. We did have some volume growth in sun and skin, but I think that's really predominantly how I would talk about it, is the majority of it is price mix.

Bill Schmitz
Okay. All right. That's helpful. And then just looking at the price per blade, do you think the industry is at peak price-per-blade pricing? Like it seems like it's gone very far. Every year it was profit-per-user per year, and it seems like you're getting some pricing friction, so do you think the category maybe went too far? And not that it's a bad thing, but do you think we're probably peaking in terms of price-per-refill blade? And then along those same lines, why aren't you more aggressive in some of the direct-to-consumer channels? Like why isn't Amazon selling private-label blades yet? It seems like a logical customer, and why haven't you maybe embraced Dollar Shave Club in terms of supplying them? Because, obviously, the product quality of the blades they're using are dubious at best, and it seems like if you're already selling quite a bit of private label, it doesn't seem like there would be a lot of channel conflict in supplying them.

David Hatfield
Okay. Thanks. On the first question, I think at the high end, it's going to be hard to move price per blade a whole lot farther over the short-to-medium term. That doesn't mean the average price per blade overall needs to be capped, because I think there's different segments of consumers, all the way through the market, and I think through innovation at all those tiers, we

can give better product, better value, higher price. So I think the trade-up remains a possibility and an opportunity for us and our customers. I think it's just not the same escalator of men's systems that it was. I think there's innovation at the top end, but that won't be, I think, the main driver.

In terms of your other questions, I think they're a little more customer-driven than I'd like to comment on for competitive reasons and just for customer reasons.

Bill Schmitz
Okay. Can I just ask you why Amazon isn't doing private label yet, though? Is there like a reason for it? Because they've got it in a lot of other categories. It seems like it would be a logical one.

David Hatfield
I'd rather not walk in their shoes. I'd rather not comment on that.

Bill Schmitz
Okay. No, that's fair. Thank you.

Chris Gough
Thanks, Bill. Now, Operator, next question, please.

Operator
The next question is from Jonathan Feeney of Consumer Edge Research. Please go ahead.

Jonathan Feeney
Good morning. Thanks very much. You answered all these questions by saying EPC or a wet shave takeaway, including private label, is down 4 [percent]. And I wasn't sure if that was a global or a North American number, and I'm trying to get to the bridge between that and the 7.4 percent organic rev growth you showed in wet shave. Is that all price mix on the lower trade spend, and if private label's growing faster within that, even with these Mach3 emulations, doesn't that give you somewhat of a negative mix? I'm trying to understand the pricing that's overcoming that, or is it international or something I'm just not thinking of? I know Sandy gave us four factors, so just the bridge between those and what's going on, I'd appreciate it.

David Hatfield
Okay. Sure. So what I was saying, the total EPC consumption down 3 to 4 [percent], that was a U.S. Nielsen, so —

Jonathan Feeney
And that's a dollar number, not a volume number?

David Hatfield
Correct.

Jonathan Feeney

Okay.

David Hatfield
And what I'm saying is that if you look at our shipments to consumption, they were generally trending with that except for the volume impacts. What I'm saying is the entire bridge from down 3 to 4 percent on the volume to our shipments up 7.8 [percent], that's all price mix, generally coupons, but also trade spend. So that's what I'm saying, and I didn't quite follow your private-label point, so if you could walk me through that again.

Jonathan Feeney
Yeah, sure. Like I gather, particularly with the Wilkinson Sword substitution, but just overall, private label's been growing faster. I would think that that creates — and correct me if I'm wrong, but that would create a negative price mix factor in general. It's a lower dollar per unit than average for your portfolio. Is that a correct assumption, as private label grows faster both in the quarter and the year, that pricing more than offsets that, is that right?

David Hatfield
So that's a different question than trying to bridge to consumption, right? So that's — I'm —

Jonathan Feeney
Well, yes, but it would be part of that. It would be partially offsetting and make the price that was needed even more. That's all I meant.

David Hatfield
I don't think that's a major part of the bridge, other than the customer takes a different percentage margin on private label versus branded, and that diverges Nielsen versus ours some, but that's not the main driver in the quarter. And I go back to the major story was lower couponing and the trade spend this quarter versus previous year.

Jonathan Feeney
Thank you very much.

Chris Gough
Thanks, Jonathan. Operator, next question, please.

Operator
The next question is from Iain Simpson of Societe Generale. Please go ahead.

Iain Simpson
Hi, there, a couple of questions, if I may. Firstly, it seems that, in general, promotional intensity was down across the board quite meaningfully for you. Is this a market wide trend, or is it more just that you were lapping an exceptionally promotional-heavy quarter? And, secondly, could we dig into the weeds on your expectations for wet shave a bit? You're talking about 2 to 3 percent growth in line with the market. Within that, are you thinking your price mix balance is likely to be pretty much in line with the market, and, if so, how should we think about that waiting between price mix and volume? And, secondly, when we think of the parts of your wet shave

business, the branded, the private label, and the online, any areas within that where you hope to be outperforming the market? Thank you.

David Hatfield
Great questions. In terms of promotion for the quarter, I have to say within the shaving business in the U.S., promotional intensity has really never been higher. Our major competitor — the percentage of volume done on promotion, both for men's systems and also disposables was higher than we've seen. So it's pretty heavy. We were down, but I think that was down versus, as you mentioned, a pretty high year ago, and I think we were at levels that we were pretty comfortable with, and we are trying to keep our focus at building baseline volume, baseline share through equity and innovation. Expectations about price and volume mix for next year, I'd just say that it's a balance, and it would be relatively in line with the category.

Sandy Sheldon
Yes, I mean, one thing to think about on the wet shave is we will have some new products, we'll have what we talked about earlier, the anniversarying through the first couple of quarters with the Fits Mach3 product, and we've got, obviously, international growth continuing, so we do have some relatively good volume growth in '17 based on our current outlook, but we also have some improvements in price mix as well.

David Hatfield
Yes, so it's kind of balanced.

Chris Gough
Thanks, Iian. Operator, next question, please.

Operator
The next question is from Andre Shetley of UBS. Please go ahead.

Andre Shetley
Thanks. Hi, everyone. I actually just have a quick housekeeping question. Your 100 percent less free cash flow productivity guidance for '17, is that based upon GAAP or non-GAAP earnings? Thank you.

Sandy Sheldon
GAAP earnings, GAAP net earnings.

Andre Shetley
Okay.

Chris Gough
Okay. Thank you. Operator, next question, please.

Operator
There are no additional questions at this time. This concludes our question-and-answer session. I'd like to turn the conference back over to David Hatfield for closing remarks.

CONCLUSION

David Hatfield
Well, thank you all for your time and your interest, and have a great day. Thank you.

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