Company Name: Coty
Company Ticker: COTY US
Date: 2019-07-01
Event Description: Business Update Call

Market Cap: 8494.55558023
Current PX: 11.3050003052
YTD Change($): 4.74500030518
YTD Change(%): 72.332

Bloomberg Estimates - EPS
Current Quarter: 0.09
Current Year: 0.704
Bloomberg Estimates - Sales
Current Quarter: 2035
Current Year: 8650.222

Business Update Call

Company Participants

- Pierre-Andre Terisse, Chief Financial Officer
- Pierre Laubies, Chief Executive Officer & Director

Other Participants

- Lauren Lieberman, Analyst
- Robert Ottenstein, Analyst
- Faiza Alwy, Analyst
- Joe Lachky, Analyst
- Mark Astrachan, Analyst
- Andrea Teixeira, Analyst
- Olivia Tong, Analyst
- Linda Bolton Weiser, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. My name is Laurie, and I'll be your conference operator today. At this time, I would like to welcome everyone to Coty's Turnaround Plan Conference Call. As a reminder, this conference call is being recorded today, July 1st, 2019. On today's call are Pierre Laubies, Chief Executive Officer, and Pierre-Andre Terisse, Chief Financial Officer.

I would like to remind you that many of the comments today may contain forward-looking statements. Please refer to Coty's earnings release and the reports filed with the SEC where the company lists factors that could cause actual results to differ materially from these forward-looking statements.

All commentary on like-for-like and net revenue reflect the comparison of the business at constant currency in the current and prior year period, excluding the impact of acquisitions and divestitures. In addition, except where noted, the discussion of our financial results and our expectations reflect certain adjustments as specified in the non-GAAP financial measure section of our earnings releases.

I will now turn the call over to Mr. Terisse.

Pierre-Andre Terisse, Chief Financial Officer

Thank you, Laurie. Good morning and good afternoon to everyone on the call. So this is Pierre-Andre Terisse, Chief Financial Officer of Coty, and I'm here alongside with Pierre Laubies, Chief Executive Officer of Coty. We are here present and pleased to be with you today on the first day of our new fiscal year to present you our thoughts about the future of Coty.

Our aspiration is to transform Coty into a consistent performer of the industry and add value to it. We believe the plan we have put together and we are going to discuss now is an important step in this direction.

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I'll move to the slide number two now. As you know, over the past several months, we have been focusing on three things; operationally stabilizing our business, meeting our financial commitments in a pragmatic manner, and identifying the path towards turning around the company. Before Pierre presents our plan to you, let me review what we have built so far in 2019. First, we are well advanced on the objective of business stabilization with the supply chain issues over, and we are both -- as we have growth, so we have been very pleased with the capacity of the organization to rebound and to react and execute clear priorities that's been a very important signal.

We are also on track to meet our financial commitments for profit and cash flow for the year. We expect the Q4 like-for-like net revenue trends to be consistent with the third quarter. As you can see on the screen, they may be likely a touch weaker, but nothing which is concerning. The operating income delivery for the year of $950 million to $1 billion at constant currency, we are very much in line with it, and we are very much in line as well with steady free cash flow for the quarter and the year-end.

The development of the Turnaround Plan and more concrete financial expectations for the years ahead have also enabled us to do two things, as is shown on this slide. First, we are in the process of raising the value of our intangible assets in the context of our medium-term financial expectation. And as a result, we expect to record an impairment of approximately $3 billion in our fiscal year '19 accounts, primarily in Consumer Beauty, reflecting lower starting points and as well more realistic expectations. Second, our credit agreement has been amended with a view to expand our operational flexibility, yet aligning with our deleverage target. The covenants have been adjusted and the amendment has been signed last week.

I want to take the opportunity as these comments on this slide to thank the banks for contributing to our increased flexibility. I also want to thank Christina Frank who has played a key role in the management of the debt financing for Coty on top of her IR responsibilities. She has now decided to pursue other goals, and Olga is now taking the lead for Investor Relations, and I'm sure she will be very successful in this.

So this is the end of fiscal '19, which has been an extremely dense and productive year, and second part of the year, and which sets foundation for our turnaround. Our business is now under control. We have a solid profit and cash flow base. We have meaningful financing flexibility and we have a clean asset base.

With this, I will turn to Pierre for him to tell you about our plan.

Pierre Laubies, Chief Executive Officer & Director

Thank you, Pierre-Andre. If we could move to slide three. So I think it's always important when we look forward to occasionally look backward and try to understand what happened and why will it not happen again. Several years after the completion of the P&G Beauty merger, it is clear that the difficulty of this merger lies at the heart of many of the issues that Coty has faced since then.

First, the complex structure of the deal meant that the following integration took longer and was more complex than originally envisioned. Second, many parts of the acquired business had weak performance since the merger, and third, the sustained commitment to meeting the financials targets set at the start of the deal limited the organization's ability to address some of the underlying trends. And that brings us to today and why we believe we are in a different position now and able to deliver on our new strategic and financial objectives.

What differentiates Coty now as compared to Coty three years ago is that, first, the integration is now complete and behind us, including a common IT and business system, and second, that we as a management team are very focused on setting realistic targets and objective. So the most important point is that Coty as a platform now is ready for an inflection.

Slide four, it is very true that the P&G Beauty merger has led to value suppression and financial setbacks for Coty. However, it is true that with the merger, Coty has built a very strong beauty platform whose quality is very often overlooked. Our brands are leader in each of our categories. We have leading position in several key developed and emerging markets, including US, UK, and Brazil. We are the leading fragrance maker with a long runway for licensed

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brands as 80% of our licenses have residual average life of nine years. And equally important, it is clear that we have very skilled people who are result-orientated and resilient as well as the leading edge IT infrastructure.

Moving to the next slide, it is clear also that 60% of our business is on strong footing. Our luxury business has grown in line to ahead of the category in the last two years. This is a testament to the great work done by Edgar and Simona and their teams. Our luxury business has clearly exhibited our strong capacity to renew our licenses, as is the case with Marc Jacobs and attract new licensees, as is the case with Burberry.

And our Professional Beauty business has suffered in recent quarter from the direct and indirect impact of the supply chain directions, but nonetheless remains strongly positioned in an attractive salon beauty industry with high barrier to entry. Our portfolio is again here, well positioned, underpinned by Wella, our mega hair brand, and OPI, our fast-growing nail brand. And again, the performance improvement over the last years that we have experimented in this business is a testament to the great work done by Sylvie and her team.

Moving to the slide number six, we can see that Consumer Beauty, on the other hand, has clearly weighted on Coty's results, but it is important to stress that we see that as a gap in performance. In the categories and geographies in which we currently operate, the mass beauty category is generally declining 1% to 2%, a level that's not great, but it's not pragmatic and alarming. The pressure on our Consumer Beauty business has really been out of share losses, which are a big component of what we are trying to address with our Turnaround Plan. And if we are able to stabilize our share in this moderately declining category, this will allow Coty to return back to growth.

Moving to slide seven, we have now identified what we need to change in our company to be lasting and sustainable performance with the focus initially on building a better business before we build a significantly bigger one. Specifically, our goal for the next four years is to reverse the negative revenue trends and significantly improve our profit margin through gross margin growth and cost control so that we are ready for accelerated growth in the future years. We will achieve this through three strategic pillars: rediscover growth, regain operational leadership and build a culture of pride and performance. Behind each of these pillar lies some very fundamental choices and business philosophies that we intend to deploy across all parts of our company.

Rediscover growth, slide eight. Rediscover growth in the immediate future will be focused on optimizing our e-store assortment, our branding fundamentals and our strategic revenue management. By doing so, we will aim to capture the upside potential in the business that we currently have. It will enable us to orient our innovation efforts going forward to support expansion of category coverage, up-trading and margin accretion. A critical part of this pillar is making choices when it comes to priority brand and priority brand-country combination so that we can invest behind those at scale with impact instead of spending our precious resources too thinly.

Going forward, we will focus on fewer brands and fewer brands-country combination so that we have sufficient support for those country-brand combination, which together account for approximately 60% of our net revenues. As a result, we will go from 20% of this priority brand-country combination to be supported at scale to 60%. And I am convinced for having experienced it earlier in my career that this will make a substantial difference to our trajectory.

Slide nine. Another dimension of this pillar is leveraging a deeper data-based approach to optimize the product assortment that we currently have. We have developed appropriate [ph] efforts to improve our shelf productivity by better optimizing assortment choices while simplifying product range and brand architecture. This includes identifying and filling gaps in our assortment, be it in higher price tiers of mass beauty, which are outperforming the underlying mass beauty category or gaps in trade, naming of key product benefits. All of this is expected to improve our productivity and drive value for Coty. To that end, over the next 24 months, we'll be deploying this approach (inaudible) marketing philosophy, which underpins it, everywhere around the world, training all of our consumer-facing teams and supporting functions.

Slide 10; hand-in-hand with this data-driven approach to product assortment and portfolio strategy is a step change in our innovation capabilities. Our R&D and brand teams will work together to develop premium product, which offer a clear benefits base on consumer insights. We have set clear objective for all our innovation efforts in the coming years to support expansion of category coverage, up-trading and margin accretion. This will be supported by a significant

double-digit percentage increase in our R&D investment over the course of the next four years.

The second pillar of our Turnaround Plan is about regaining operational leadership. As we look to close our performance gap, we must address cost and complexity throughout the business. We estimate our gross margin gap versus competition to be 10 percentage point on a comparable basis. We want to close a very significant portion of that margin gap over the course of the next four years so that we can fuel our ability to invest whilst decreasing the debt of the company.

Although we have already made headway in optimizing our supply chain footprint, a large part of this turnaround pillar focuses on improving cost of goods sold through accelerating supply chain productivity programs, direct procurement saving, logistic saving and optimization through the existing supply chain footprint. Another component of our gross margin attack centers on rationalizing SKUs in sub-ranges and value engineering of lower margin SKUs. This will drive product range complexity -- sorry, this will reduce product range complexity, increase cost margin, drive better shelf productivity and increase supply chain efficiency. It is a mission-critical task, and we will mobilize our collective energy to achieve it.

Part of our performance gap is also in excessive overheads, and we have also concluded that we must optimize our organization both from a cost as well as from a structural point of view. The way we function today is neither fit for the company of our size, nor for the culture that we want to create. It is with that in mind that we are announcing organization changes that align our cost with our revenues reality, simplify decision-making and enable our teams in the market to act with closer guidance and with greater speed.

Here are the key changes. Our future design intends to position our key market closer to the Executive Committee. Two, we will split commercial and marketing responsibilities. This will enable greater focus on portfolio synergies, brand assets availability and innovation pipeline building on the marketing side and operational excellence and market focus on the commercial side. Three, the new design fosters creating scale in the markets as well, in which all markets are expected to be supported by mutualized function.

This is the new micro structure of our business. Moving to the next slide please. We expect from the current organizational structure into regional commercial teams and brand marketing units for Luxury and Consumer Beauty as well as creating new regions, Americas, Asia-Pacific and Europe, Middle East Africa. Professional Beauty is expected to remain a distinct business unit due to its unique salon channel focus, though with the same principle of the key markets reporting directly to its President. With P&L ownership expected to reside in these new four segments, Americas, Asia Pacific, EMEA and Professional Beauty, we plan to move to this reporting structure at some point in the coming years and we'll keep you updated on the precise timing.

It's important to note that while we are reconciling some of the organizational components, our commercial front-line, the local sales and marketing team facing our customers and building our brands locally will see little impact and will remain specialized in their respective products and sales channel. And while we're streamlining organization cost through delayering and mutualization, our sales and marketing force is expected to have negligible impact.

Finally, to transform our company, we need to transfer ourselves. Evolving our culture is a key building block of our transformation as well as providing our associates with a framework which allows them to grow as we grow our company. However, we need to address a limiting issue. Today, our global teams are spread in several locations. We have therefore decided to collocate most of our executive team and corporate function in one location. By doing this, we expect to reduce geographic fragmentation and cost while at the same time fostering co-creation and faster decision-making.

After careful consideration and looking at multiple factors, we have decided to place our management headquarters in Amsterdam. Amsterdam is a cost-efficient and tax stable location conveniently located for travel to Coty's key markets, has a strong base of FMCG talent, and share a lean culture mentality adequate to our challenger status [ph]. We believe that the new setup will not only drive scale, but also lead to greater speed, efficiency and ultimately business result.

The new organization design is expected to be in effect by January 1st, 2020. The full structure implementation and management headquarter consolidation are expected to be completed by July 1st, 2020, subject to legal processes

where required by local regulation.

As we embark on our third pillar, build a culture of pride and performance, our turnaround will be led by a team of seasoned executives that you see on that slide with a good balance of beauty and FMCG expertise and embodying the diversity whilst striving to champion within our organization.

With that, let me turn it over to Pierre-Andre to walk you through the financial underpinnings and targets of our Turnaround Plan.

Pierre-Andre Terisse, Chief Financial Officer

Thank you, Pierre. So let me now explain to you what this means in terms of numbers, and I will start with a slide on revenues. On revenues, we've been, in our projection, realistic. We do not expect, altogether, revenues to be higher by full-year fiscal year '23 than what they have been in 2019 , and therefore we expect them overall to be stable.

However, their composition -- the composition of our revenues will shift in reality significantly. As you can see on the screen, we expect Luxury and Professional Beauty to continue growing at a similar pace, 4% in the case of year-to-date Q3 for Luxury compared to 3% to 4%, minus 1% for Professional Beauty, which had been impacted specifically by the supply chain issues and we expect them at zero to 2%. Their weight resulting from the continuous growth, their weight in the growth of the company will increase by -- in the revenues of the company, sorry, will increase by 5 points, and that's going to be an improvement of our mix.

More importantly though, we target, as already mentioned by Pierre, to stabilize the market share of Consumer Beauty, and therefore we expect that this is going to improve our performance significantly moving from the current minus 10% at the end of March to minus 1% to minus 2% in full year '23. And altogether, we therefore expect to exit the plan with a low-single-digit growth at constant foreign exchange and perimeter.

Many drivers are going to contribute to this. In fact a lot of the plan is going to contribute to it. I would just like to outline two specific factors. One is priority brands. When we say that we are going to invest significantly behind priority brands, the financial translation of that is that they are going to gain 10 points, moving from 60% of our portfolio to 70% of our portfolio, and this is going obviously to generate positive mix.

Second is the geographical element with Asia, which is currently growing fast, high single-digit, and we expect that if it continues to grow at the same speed, it's going to move from the current less than 10% of sales to close to 15% of net revenues by the end of the plan. So these are two examples of what is going to impact the revenues, which, again, are overall going to be stable in '19 to '23, but in reality inside changing deeply.

Moving to the following page, I think the beginning of the message is very much the same, i.e., you can see that with net revenues stable, as I just described, still this is going to have a positive impact on the gross margin. Their evolution is going to have a positive impact on the gross margin. Because we are going to review our assortment, because we are going to adjust down the level of promotion, because we are going to use innovation, and all these elements are going to contribute to a positive evolution of the mix and value, therefore adding a positive impact on the gross margin.

This is going to be further helped by the -- by higher A&CP advertising, which we will drive towards level more in line with industry practices, also shifting our investment to working media, both digital and traditional. These three investments, which is extremely important behind advertising is going to be made possible, thanks to strong progresses on the cost side, as described by Pierre. On the COGS side, thanks to strong productivity work making our platform fitter while increasing service level and delivery to the business, and thanks as well to less complexity and related hidden cost, on the fixed cost with the reorganization, which will address the scale of our markets through the mutualization of our support functions, with the delayering as well of the organization, and last with productivity on non-people cost.

Our objective is that relentless cost efforts will allow us to increase the fueling of our brands and that the right prioritization will gradually make the plan a positive lever rather than one which creates pressure. Over the period, we

expect the combination of these levers to help us grow operating margin from the current 11% to a level of 14% to 16% by 2023, which is a progression of approximately 30% to 40%. At which point, the generation of cash flow will also have to start reducing our debt and grow our EPS faster than our operating income. So what we are aiming at here is really to build a sustainable income growth, and I insist on the balance of value and mix on the net revenue side, A&CP and cost, which we expect to build a virtuous circle.

On slide 16, as you know, one of our priority is to generate cash and to deleverage our balance sheet. So we expect to raise our free cash flow generation to $1 billion in fiscal year '23 from the current level of $200 million to $300 million in '19. This will mainly be achieved through the progression of the EBITDA, of course, the operating income and the EBITDA. To implement the plan under various sections, we've mentioned before, we expect to incur one-time cash costs of $600 million, which will be incurred over 2020 and 2021 for most of them, and which are going to generate savings within two to three years.

We do expect working capital to contribute to free cash flow improvements, thanks to a reduction of receivables, and maybe more importantly, work we have to do on the inventories and which is going to be helped by the simplification work. And last, we expect our capital expenditures to stay within 4% of our net revenues. As a result of these actions, we expect debt to decrease, contributing to our objective to get back to a net debt to EBITDA of 4 times net within the timing of the plan.

I would recap on the financial targets, page 17, within the timing of the plan, so by 2023. For fiscal '23, we look for net revenues to be stable to -- sorry, to be flat to up to 2% in 2023, resulting in relatively stable absolute revenues compared to fiscal year '19. We are targeting adjusting operating margin of 14% to 16%, and we've targeted free cash flow of approximately $1 billion. We expect to bring our leverage down to below 4 times. As mentioned earlier, these targets are both challenging and achievable relative to our current starting points. At the same time, we do not believe that this represents the maximum potential of the business as we see further opportunity for revenue acceleration and margin and cash flow expansion beyond fiscal '23.

Moving to page 16 or -- 18, sorry, that's my eye, I'm getting old. Today, 1st of July, is also the first day of the first year of this turnaround and the plan will obviously start impacting our financials in 2020 with the following targets we're happy to share with you. We expect for 2020 like-for-like net revenue declines to moderate from fiscal '19. We expect solid progress on gross margin shooting higher NCP investments and we are targeting 5% to 10% adjusted operating income growth at constant currency and we also expect moderate improvement in free cash flow.

You should note that our new company-wide incentive system will be aligned in '20 to these financial objectives and focused on three key performance indicators, which we believe are essential: gross margin, because this is measuring the quality of the revenues and the work we do on that side; operating income, as it has been in the past, and free cash flow, because the deleveraging of our balance sheet is an essential component of our financial strategy.

Just to conclude this presentation, a few words. Please keep in mind that this Turnaround Plan relies on a few principles and we are going to continue leveraging on those. The first one is better before bigger. We are really looking for quality in everything we do. The second one is to follow the laws of the turnaround and we are specialist of this kind of situation, and Pierre is an obvious example of that, following the laws of the industry as well. We are a good blend of turnaround people, consumer people and beauty people. And the last is that we say what we do and we do what we say, and all good here. It's not to make you dream, but rather to build a plan which we will deliver, which will make Coty competitive and prepared to grow once the turnaround is effective.

So I thank you for your attention and we are now ready to take your questions and try to answer the best we can with Pierre.

Questions And Answers

Operator

Thank you. (Operator Instructions) Our first question comes from the line of Lauren Lieberman of Barclays.

Lauren Lieberman, Analyst

Great, thank you. Good morning.

Pierre Laubies, Chief Executive Officer & Director

Good morning, Lauren.

Lauren Lieberman, Analyst

I was wondering if you could talk a little bit about the process by which you assessed kind of brand health, portfolio choices you're making and to focus in on this brand-country combination work that you've done, so the process by which you went through that. And also, is that done? Sort of you've given us the high level, here's how we're going to think about the world, but you've not given us much in terms of what those priorities are actually going to be. So if you can shed any light on that, it would be great. Thank you.

Pierre Laubies, Chief Executive Officer & Director

Well, I think, yes, it is done, it's mostly done. Something I want to highlight a bit before -- this recipe is the product of the work of a lot of people. We almost had at a point, I would say, 120 people working in the organization building this recipe. So this is not like a top-down exercise. It's a ground -- it's from the ground, and it's really based on insight that reveal through analytics. And so, basically speaking, these brands are well known. I mean, we have a clear portfolio of brands which have the potential to be global. We have about 12 of these brands, they are in our organization, very well known. I mean, like -- and they are by and large our biggest brand and the one we have already covered. If you look at a brand like Rimmel, it's a brand which is present in 26 market to 30 markets around the world. So it's already a brand, which is there, which is distributed. Now it needs to be supported.

So -- I mean, without revealing too much competitive information -- and we have clear -- we identify what matters for us is do these brand already have an asset or in term of penetration, in term of image, in term of awareness in the marketplace, and are they -- are they playing a clear role in the portfolio. And I think that's the way we use -- that's the way we use to define them.

There are also a set of brands, which do not have the potential to be global, but yet are very important and we exactly know what these brands. Take an example, if you want to illustrate what I mean. If you take a brand like Bruno Banani, it is a very strong brand in the German market. It has a lot of penetration. We don't consider that it has the potential to be a global brand, but yet, we will manage it and support it in the German market so that it continue to drive and develop -- just drive and develop into the German market. So we have that pretty much bottom-down everywhere. We have a few brands which are in the question mark list, and again, we are doing -- going to do our work, and there are about four brands in that question mark list. Do they have the potential to be global? Are we going to give them local, but yet invest into them at the local level? So these are the classic type of conversation that we need to have. And we'll finalize this conversation over the course of next three to four months.

Lauren Lieberman, Analyst

Great. Thank you.

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Pierre-Andre Terisse, Chief Financial Officer

Thank you.

Operator

Your next question comes from the line of Robert Ottenstein of Evercore ISI.

Robert Ottenstein, Analyst

Great. Thank you very much. Two questions. One, how do you plan to keep the focus -- some focus on revenue growth, revenue stability while you're going through this process when it looks like all the key metrics for management are more cash flow or profitability driven? And second, can you talk a little bit about the $600 million of cost to take out and to deliver on the plan and where that $600 million is coming from? Thank you.

Pierre Laubies, Chief Executive Officer & Director

I will take the first part of the question and Pierre-Andre will take the second one. We have high intention to keep focus on revenue growth, and particularly, we have high intention to keep focus on the velocity of our shelf power. So again, we have run now, I would call it like six fundamental analyses of our position, and when I mean fundamental, to the lowest possible level of SKU, to the shade level, to the shade naming, to the price point of these SKUs and the way they are built to the level of sub-ranges and we, basically speaking, have analyzed and captured insight in detail in Consumer Beauty on four market, US, UK, Germany, Brazil; in luxury, in two market; philosophy in the US and in the UK market, and we are starting to deploy this technology and this approach on our market in the -- on our -- out of -- sorry, on our professional beauty market in the US. So we have a ton of insight about how we can drive our business better.

And honestly speaking, we will, I would call -- have one of my favorite line in business, which is people do what you inspect and not what you expect, and as a consequence, we are going to have the control tower on the deployment of our OpEx programs across our markets and the one I've indicated here, and basically speaking, we are going to have with these markets a monthly review at senior level and how we're deploying these assets, all these strategies, whilst at the same time, we will expand this knowledge and know-how and this philosophy of doing business across the entire company over our guidance term of two years. So no markets will be left unturned. I really believe that the data that we have here is very strong and that we have very, very clear strategic and actionable insights to enable us to turn around the fundamentals of some of our markets and categories. And we have the ways of working, which we had to keep the focus on them.

Pierre-Andre Terisse, Chief Financial Officer

Thank you, Pierre. And to complement on that, don't forget that we plan to step up the level of commercial investments significantly, and you would have noticed throughout the presentation that we give a pretty important share to the management of revenues, focusing more quality than quantity indeed, but still, to the management of revenues.

On the second question, which is about the $600 million one-time costs, so we expect that to be essentially two pieces. The majority of it, $500 million, is going to be related to the change of organization, which really is about de-layering to have more direct communication and action between the markets and DC, which is about mutualizing the support functions in the markets, reviewing [ph] the organization, and we expect this $500 million relating to the change of organization to generate close to $200 million saving. So that's the first part. The second part is going to be about various elements, including the implementation of the overall turnaround and including as well some elements relating

to supply chain and simplification, and this is about $100 million, which will have as well payback within similar metrics. Yeah. I think that's really what I wanted to say about that. Thank you.

Operator

Your next question comes from the line of Faiza Alwy of Deutsche Bank.

Faiza Alwy, Analyst

Yes. Hi, good morning.

Pierre Laubies, Chief Executive Officer & Director

Good morning.

Faiza Alwy, Analyst

So I was hoping you could drill down a little bit more around how you expect to stabilize Consumer Beauty specifically. So are there specific sort of brand-country combinations that you can share with us where your focus will reside? And then, I was curious, you've talked a little bit about up-trading in Consumer Beauty. Over the last few years, we've seen a number of other mass cosmetics brands that have attempted the same without much success. So I was hoping if you could talk a little bit about that, if you've studied those strategies and what you've learned from that and what you intend to do differently.

Pierre Laubies, Chief Executive Officer & Director

Well, I think that -- I mean, how do we intend to stabilize Consumer Beauty? We intend to stabilize Consumer Beauty by doing a better business, by doing our job better, and it's all about what we put on the shelf. I mean, at the end of the day, the conversation around that -- around the subject is quite simple. Today, we just have too many item which have low velocity and the item which is high velocity don't get enough space. So broadly speaking, it's going to be a function of assortment management, it's going to be a function of rationalization of the number of sub-ranges. We just have too many sub-ranges, we need to reduce that. And then it is going to be a matter of investing at scale behind the key brands that we have identified. So I guess that without revealing, again, too much competitive information, you can see the fabric of that is just fundamentally returning to the fundamentals on advertising, the fundamentals of the understanding of distinctive assets of the brand and the fundamentals of pricing and activation. So -- and again, we do believe that we have a lot of opportunities and the data we have is very strong on the subject.

How to trade up in Consumer Beauty? I think that the general answer is, you can trade up brands up to a point and once you pass that point, the brand snaps and the consumer doesn't follow you, and as a consequence, to trade up in Consumer Beauty, you need a portfolio of brands, and that will be our strategy going forward. We do know that the route going forward is to actually understand where are the brand rooted; are they rooted in mainstream, are they rooted in premium, are they rooted in sub-premium, and then within that partition, to up-trade the brand as much as possible. But if you want to up-trade your business, you need to have a portfolio strategy. And that will be, I would call, if you want to see a departure in strategy between a before and an after, that will be the departure in strategy that you will see.

Faiza Alwy, Analyst

Okay. And then if I may just ask a second question that's around M&A. So there have been some recent news reports around Coty taking a minority stake in Kylie Cosmetics. So I was hoping if you could make a general comment around that. And if not specifically around that, then whether over the next two to three years you intend to look at M&A opportunistically, or do you intend to entirely focus on the organic business? Thank you.

Pierre-Andre Terisse, Chief Financial Officer

Okay. It's Pierre-Andre. I'll take this one. No comment on any rumor, whether you're talking about this one or any other obviously. Maybe to talk about the way we approach M&A, there are two important component. The first one is that turnaround is our priority. We believe the best way we can create value is going to be focusing on our turnaround, and that means leveraging the existing platform. Nevertheless, we are also conscious that we have some strength but also weaknesses in our brand portfolio. We have underexposure in some regions like Asia. We have underexposure in some segments of the markets like skincare or like premium, and therefore, over the course of the coming years, with no hurry, no rush, we'll be looking at opportunities which come to us and assess whether or not we can seize the opportunities to improve the portfolio and to allow the company at the end of the turnaround to accelerate its growth.

You have to keep in mind something which is extremely important for us, and this is that whatever we do, this is going to take place within the frame of our objective of bringing the leverage, the financial leverage of this company down to 4 times. We have taken a very public position vis-a-vis that. It's an important part of the financial policy. And again, whatever we do is going to be within the boundaries of that. So that's what you need to have to understand the way we are going to approach whatever opportunities we find in front of us.

Operator

Your next question comes from the line of Joe Lachky of Wells Fargo Securities.

Joe Lachky, Analyst

Hi, thanks for taking my call. Just wanted to ask, I guess, your confidence in the long-term operating margin target since it seems fairly ambitious compared to where you are, where the company has been historically, and I wanted to talk about the drivers of how you get there. Obviously, it sounds like some on the fixed cost side, but mainly on the gross margin improvement. And what is behind that 10% gap in gross margin versus competitors? How much low-hanging fruit is there? And how quickly do you expect the improvement to take place and how much of that gap can you close in the next four years? Thanks.

Pierre Laubies, Chief Executive Officer & Director

I think that the -- actually, I really believe that the root cause of the low margin is actually the product of a relatively vicious circle. So basically speaking, have to -- confused -- I mean, I would say strategically, in businesses, it starts by actually having the wrong understanding of why you are losing market share or why you are gaining market share, and basically speaking, then the next step that the organization takes is just move into a hyper-innovation phase, and from this hyper-innovation phase, you get into a hyper-complexity phase and from the hyper-complexity phase, then you start spreading your resources too thin, and as a consequence you spread your resources too thin, then your brand doesn't have -- start to lose some equity and then you start to lose pricing power and so on and so forth.

So I think that overall, the only one way when you are in a situation like that is to get back into a virtuous circle and the virtuous circles start in general by simplifying the portfolio; simplifying the portfolio, declaring where you are going to invest, declaring where you are going to innovate and declaring and focusing the energy of the organization on building brands versus making sales. And so you would have noticed that since the moment that we took the decision altogether

at the beginning of this calendar year that we were going to forecast our business on a realistic basis and we were not going to promote business at all cost, then we have hit consistently month-after-month our sales target without too much problem. And as a consequence, our customer satis [ph] level has improved, our consequence -- the level of, I would call it, serenity in the organization and ability to work on the fundamentals has increased.

So I think what gives me the fact that we are going to close a substantial part of this gross margin gap is that we are going to do our job well and we are just fundamentally going to simplify our portfolio well, fundamentally going to advertise our key brands at scale, and we will be up-trading our -- we will be up-trading our ranges, we will be reducing our number of sub-ranges from 25 sub-ranges sometimes for one brand to seven, and I promise you, it will have an effect on our awareness, it will have an effect on our brand equity, and as a consequence, it will enable us to follow the pricing trend and the up-trading trends of the marketplace, and this is what will do that. And we will -- it will enable us to reduce our level of business on deals [ph] and focus on selling our product at full prices to the consumer. And so overall, I do think that the combination of this work on the fundamentals, on the assortment as well as the work that we will be doing on the manufacturing side and the cost side of the business will enable us to close about 60% of the gap that we have identified versus our competition over the course of next four years. Want to add something, Pierre-Andre?

Pierre-Andre Terisse, Chief Financial Officer

Yeah. Just about the word ambitious, we're ambitious. And at the same time -- we've said it several times, so I will repeat it, it's important for us to be in a position to deliver and to manage the pressure on the teams in such a way that it puts them in the position to deliver. So as Pierre said, we don't assume that we'll be able to close the gap in the coming four years, that's a substantial part of the gap. There are a lot of moving -- a lot of different parts contributing to it. A lot of them come from the cost side, which is very much under our control. A lot of them come from the transportation -- transformation of the top line. We have not forgotten to reinvest money in advertising and promotion, which we believe is necessary and which (inaudible) is an important part of the game. So, yeah, we're confident. We're confident.

Pierre Laubies, Chief Executive Officer & Director

I think personally the story of Coty is, it's a quality of business story that we talk about here. Quality of our margin, quality of our organization cost, quality of our balance of investment between working media and non-working media, quality of our investment between media and promotion. I personally believe that there is always a lot of value unlocked into making these very fundamental shifts.

Pierre-Andre Terisse, Chief Financial Officer

Next question?

Operator

Your next question comes from the line of Mark Astrachan of Stifel.

Mark Astrachan, Analyst

Thanks, and good morning, everybody. I wanted to follow up on the last line of questioning on gross margin. I guess, if you take a look at the comparison versus peers, it just doesn't seem obvious to me at first blush that the category combinations you have relative to those peers make it readily accessible. I get your commentary about just executing better and volume and sales growth, underperformance leads to some gross margin delta. But I guess, if you look at it

on a category basis, your luxury portfolio versus other companies', for example, you're more skewed to fragrances. If you look at some of those licensed peers are a bit lower than a L'Oreal or an Estee Lauder. So what are you looking at specifically that gives comfort within your specific portfolio that you can close the gap that you think is really there and obvious? And maybe you can look at Consumer Beauty as well where those tend to be a little bit lower -- kind of low 60s if you look at peers at least that we've seen, Professional maybe kind of somewhere in between. So I guess if you can give more comfort there maybe on a segment basis, that'd be helpful.

Pierre Laubies, Chief Executive Officer & Director

I can give you a simple insight, for instance, on luxury business. I mean, the balance of our assortment between (inaudible). I mean, we, our level of assortment is a bit lower in the low part of the portfolio, and a little bit too high or the balance between the premium part of the portfolio and higher part of the portfolio -- the premium part of the portfolio and the mainstream part of the portfolio is -- can be improved, the same in Consumer Beauty. I mean, fundamentally in some markets, we like mainstream penetration. We have -- in emerging markets, we like mainstream penetration, but in other developed markets, I think we only operate with one brand. We should be able to operate with a second brand and we should be able to operate with a second brand at a higher price (inaudible).

And so I think, again, I mean, the sort of insights are on all of that, and again, we have SKUs which are margin accretive and we have SKUs which are margin dilutive. The percentage of our SKUs which are margin dilutive is just too high. So we need to rebalance the proportion between the SKUs which are first driving penetration and, two, margin accretive and the SKUs which are margin dilutive and not driving penetration and the one which are margin dilutive, but driving penetration, we need to value engineer them. We have clustered all our SKUs between these four buckets and we are going to work at them in a consistent basis over the course of the next 24 months, and it is a very substantial undertaking. But it is fundamental that we address this level of complexity in the organization. Today, we have, I would say that we have 60% of our SKUs which are margin dilutive. It's an incredibly high figure.

Pierre-Andre Terisse, Chief Financial Officer

And adding to that, we believe that the gap we have in terms of gross margin overall is in fact higher than 10. 10 is the low part of the scale when we look at it. You can read the same guide, by the way when you look at the operating income, we are running at kind of 11%; peers are running at 17%, 18%. So you find a substantial part of the gap. When we look at the division mix and the country mix, we're going to find 2, 3 points, which indeed explain -- could explain why our gross margin should be lower, but they do not take us apart from the conclusion that there is a gap of roughly speaking 10 points, which we have to close. And by the way, which, when we close it, is going to allow us to close as well part of the gap we have with our peers in terms of media investment and therefore as a net position closing the gap in terms of operating income.

Everything we see, as Pierre has said, at the micro level is comforting that. The way we've been operating, the fact that we've been pushing revenues and to push revenues that we've been promising heavily and that we have not been sufficiently careful about launching accretive innovation, about having an accretive approach whenever it comes to product. So we don't feel there is any reason for us to say that structurally, Coty being what it is, each will be staying at 11% operating income and each will be staying 10 points away from the competition in terms of gross margin. We see this gap very clearly macro-micro and we are going to get organized to close that.

Operator

Your next question comes from the line of Andrea Teixeira of JPMorgan.

Andrea Teixeira, Analyst

Hi, thank you and good morning and afternoon there. So if you can please elaborate more on the local currency 5% to 10% growth in operating income for fiscal '20, what is your level of investment in marketing? I understand that, as you pointed out before, obviously it's a process as you rightsize your company and SKU level improves that 10 basis points change, that 10 points of margin could eventually be reinvested. But I'm looking more into the 2020 guidance and how we should see that flowing through in 2020. And related to that, you mentioned that, what is the timeline of either shutting down or divesting some of these brands and country combinations that represent 40% of your net sales and they are (inaudible) priorities. So in other words, you just mentioned that in 24 months, your SKUs will be right-sized. So I'm, I mean, just thinking of the bridge so that the SKU rationalization and, in other words, if you're willing to do a major rationalization as you did in fragrances a couple of years back in order to get into your margin guidance. Thank you.

Pierre Laubies, Chief Executive Officer & Director

Okay. I'll take that. The question you're asking is really what we are going to be on in the coming weeks and months and years. About -- the way to think about the prioritization of brands and prioritization of SKUs is not a big bang. What we think is extremely important is that we have received market-by-market, brand-by-brand, giving priority to execution. And by the way, there is no divesting of brand plan and no divesting of SKUs. It's more reworking the priorities.

As for '20, '20 is going to be a very important year because this is the first year of Turnaround. And if you wish, this is the year when we change direction; when we start having sales, which yes keep decreasing, but at a pace which is moderating; when we start adding pricing and mix, so value, contributing positively and not any more negatively; when we start stepping up meaningfully the level of A&CP; when we start the COGS reduction or we continue the productivity on COGS and we start, in some markets, the simplification of SKU; when we start the reorganization program, which we have just deferred. So it is going to be essential to us to manage these levers altogether and to face them in a way that is really turning around the business. So 2020 is very beautiful. We've been willing to, on the one hand, show and reflect that we want to increase the operating income after '19. And this is the reason why we set for ourselves an expectation of 5% to 10% increase of the operating income at constant currency. But we want to keep flexibility because for us it's extremely important that '20 is building the path for the coming years. It's the first year -- it has to be the first year in line with the Turnaround Plan, but it has to be preparing as well the rest of the plan.

Operator

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

Olivia Tong, Analyst

Hi, good morning. I was wondering if you could talk a little bit about whether you chatted with the retailers about some of the changes that you are making. It's great to see the improvement in terms of margin, but I'm just wondering, with no revenue improvement plans, whether you had a chance to discuss it with your retailers and what their thoughts are relative to your plan. Thanks.

Pierre Laubies, Chief Executive Officer & Director

Yeah. We are sorry, but there is a lot of noise with you and we've not really been able to hear your questions. Will you try to repeat it, please?

Olivia Tong, Analyst

Sure. My question was just around whether you've had a chance to discuss your plans with the retailers and whether they've had any comments on your plan, given that it's a lot around margin improvement, but not anything in terms of revenue improvement.

Pierre Laubies, Chief Executive Officer & Director

I think we are actually -- in some markets, we are already into action with our retailers, and typically the UK and the US will be the first one with who we are talking. And when we explain the logic of what we want to do, I would say that they answer positively about -- they answer positively to our strategies. And typically in the US, where we have, I would call it, our new rigorous approach on the brand-building, reinvestment behind COVERGIRL, going back to the distinctive asset of the brand, this is something which resonates with our customers and the same in the UK where we actually say we want to simplify our portfolio and focus behind two brands at scale in this market instead of spreading our effort around 3.6 brands, then they respond positively to that too. So I think the answer that we have today is positive because the plan comes across as sensible, I would say.

Operator

Your next question comes from the line of Linda Bolton Weiser of D.A Davidson.

Pierre-Andre Terisse, Chief Financial Officer

And this will be the last question, by the way, please.

Linda Bolton Weiser, Analyst

Hi.

Pierre Laubies, Chief Executive Officer & Director

Hi.

Linda Bolton Weiser, Analyst

Can you comment on how you see the plan being modified if we were to go into a global type recession at some point in the next four years? Thanks.

Pierre Laubies, Chief Executive Officer & Director

Unlikely to be modified. I mean, to be honest with you, I think it is -- it is a plan which aims at resetting the fundamentals of Coty. That task is to be done regardless of the environment. And I think that honestly speaking, yes, we will adjust, we'll adjust probably when you have a globalization, some market changes. But the fundamentals -- I mean, my view -- this -- I don't know exactly the effect of recession on these categories, but the frequency of purchase is not that big, right? So that will be an effect. But at the end of the day, my -- our main focus is to build a better business. I'll be honest and I'll be focusing on that, and whatever is happening, in tough time or in good times, this work needs to be done. And there is no shortcut to greatness. And you have to do the hard work, you have to do the fundamentals right. And I think that's what our team has -- believes in now today, and I think that I will conclude on that. This is not the easy -- this is not the easy plan. This is the plan that a lot of people have contributed to build. And

the level of alignment in our organization is, I would say, maybe I feel optimistic, but I do feel that this is higher than ever. And I think people have a clear understanding of what is expected from us and have a clear understanding of what's our glide [ph] back to success and what are the milestone that we need to go through. And recession or not, we will focus on delivering this plan consistently and monitoring our performance as we move week after weeks and month and month.

Pierre-Andre Terisse, Chief Financial Officer

Okay. Well, thank you, Pierre. Thank you. Thanks to all of you. We'll have opportunities to continue discussion in the coming days with you. So we thank you.

Pierre Laubies, Chief Executive Officer & Director

Thank you.

Operator

Thank you for participating in Coty's Turnaround Plan conference call. You may now disconnect your lines, and have a wonderful day.

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