Company Name: Coty
Company Ticker: COTY US
Date: 2019-09-03
Event Description: Barclays Global Consumer Staples Conference

Market Cap: 6870.73216475
Current PX: 9.11
YTD Change($): 2.55
YTD Change(%): 38.872

Bloomberg Estimates - EPS
Current Quarter: 0.072
Current Year: 0.686
Bloomberg Estimates - Sales
Current Quarter: 1962.375
Current Year: 8213.2

Barclays Global Consumer Staples Conference

Company Participants

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

Other Participants

- Lauren Lieberman, Analyst

Presentation

Lauren Lieberman, Analyst

So, rounding out our presentation today, we're pleased to welcome Coty to our conference for the first time this year. Since its IPO in 2013, Coty has been a company in transition with the goal of becoming a more competitive global beauty company. Today, nearly three years since merging with P&G Specialty Beauty assets, Coty is once again at a turning point.

In early July, the Company's new management laid out a four-year turnaround plan, which includes a data-driven roadmap for stabilizing consumer beauty, driving EBIT margins into the mid-teens and reallocating resources to its scale of country category position. Here today to discuss this turnaround plan in more detail and provide perspective on recent business performance, we have the Company's CEO, Pierre Laubies; and CFO, Pierre-Andre Terisse. Thank you both for being here.

Pierre Laubies, Chief Executive Officer

Thank you, Lauren. I'm extremely impressed. This is the first time that my name is pronounced correctly in such a setting because I have heard many iteration of my name. So for those who don't know me, my name is Pierre Laubies. And as you can hear, I'm super French. And so, why did we title this thing iconic brand builder? Actually because this is what we have been historically and we didn't get there by accident. This is what we are. But we are also going to have to do more of it to get out of the -- to continue to improve the performance -- or the -- of our business going forward.

Well, we have a certain number of gems which are a bit unknown. And as Lauren has alluded, happily the conversation always starts with our Consumer Beauty business. But actually, there is more to Coty than a challenged Consumer Beauty business for the sake of the argument. We have a certain number of very strong position. We have a certain number of very strong category, on which we have barriers to entry. We have deep core capabilities, but also evidently, we need a way to unlock value or we have created the roadmap to unlock value in -- across all our different categories, including our Consumer Beauty business.

So what do I mean by the strong asset base in consumer goods or in our industry? Asset base are very often a combination of market position, brands strength, or brand equity, and deep core capabilities in the business. So looking at our business we are one of the very few pure players in beauty, which operates across many channels. We operate on across the luxury business. We operate across the mass business. We operate across the professional business. And we operate at different level of strength evidently across all the subcategories, all the subpartitions as we call them of our industry, fragrances, cosmetics, hair care, skincare and body care.

Some at a higher level than others, and evidently this impacts or favor or disfavor the growth rate of the business based on the weight the opposition in each of these categories. There is also another portfolio, which is a portfolio of markets, right.

Looking at our business. First, let's talk about our Luxury business. We are the Number 1 leader in the fragrances business in the world, all right. Out of the Top 10 fragrances in the world, we have three. We have Calvin Klein, Hugo Boss and Gucci. And we have with brands like Burberry, with brands like --

Pierre-Andre Terisse, Chief Financial Officer

Tiffany.

Pierre Laubies, Chief Executive Officer

Tiffany, an opportunity to continue to bring more brands. I'm sorry, I'm learning my portfolio as you can tell. And we have an opportunity to bring more brands into this Top 10. This is our intention. We are going to continue to build our brands. We have mechanics to do that, but we have a combination of discipline and creativity which is going to get us there. The second thing -- the other thing that we have across our portfolio, an average license life of eight years and with a traditional very strong renewal track record.

What are we doing with this business? We have improved this business over the course of the last two years, mostly first by really doing our job, going back to the fundamentals, working on our brand equity, working on our distribution, making sure that we had the ability to fund our expansion. And as you can tell, we have been steadily improving the performance and the top line of our business, which by actually being -- by growing at the same rate of the market, whilst at the same time, we have been systemically and systematically improving the financial performance of this category. There is room for further expansion, albeit of course, probably at a slower pace than the one we have been experiencing so far. But clearly, we see here a path to growth and we have the -- we have demonstrated the ability to do it.

Where we see our business path to growth? We actually see it in the ability to take these brands and move them to just being luxury brand to being larger to operate across other partitions to the market. You can see the luxury business is about -- sorry, the fragrance business is about $35 billion, but there is another $60 billion on the right of that chart where we actually do not operate and we have demonstrated, for instance, by the relaunch of the Gucci make-up business or our ability to take these brands and get them to travel across the other part of the luxury segment.

For instance, the launch of Gucci lipstick has been a very, very powerful success. In one store in Asia, on one day, we sold 33,000 lipsticks. I could not believe this could happen, but this is the reality, and more than 1 million lipsticks have been sold over the first month. And we have on that business very, very strong momentum, setting 55% of this business online, and we do know that lipstick is the first step. We will continue to expand in the other partition of the cosmetic market with that brand. And we clearly have other brands, which can have the same journey. We are talking of Burberry, for instance, going forward. So we feel strong about our capability in that.

Clearly, there is one category where we are not happy today with our performance, it's on skin care. It is evident that this is the fastest growing segment of the business. We do not operate, we do not yet have a significant market share. But that doesn't mean we do not have capabilities, all right. And I take an example like Lancaster, which is a brand which is about $100 million in revenue, which was born out of skin care historically, travel too much, honestly speaking, in the sun care protection business.

And we are bringing it back to its roots. And this is exactly what is happening today for us in China where we are Number 6, the sixth brand in skin care in Sephora, for instance, in China. And the same, we had this capability -- we have demonstrated this capability with one like philosophy, which is today spot on-trend. Natural is big. Natural is going to be bigger going forward. And we have already started -- are starting the deployment of this brand today in

China and Korea, and we do know that this will work going forward. Did I do [ph]something?

Pierre-Andre Terisse, Chief Financial Officer

No, I'm sorry.

Pierre Laubies, Chief Executive Officer

Okay. So I think, again, it's a space where we are clearly committed to -- we are clearly committed to grow, but we do not start from scratch. We have a good base and albeit small, but we'll build from that.

The second asset that this Company has is the Professional Beauty business. It is a business, which has high barrier-to-entry, a high level of loyalty, and our salon customers have a very, very high repeat purchase. Why is it a business with high loyalty? Because of this, because of Wella. I have discovered moving into this business that there is something, which is called a good habit and a bad habit.

And clearly for our customers, hair color in the hairdresser salon business, hair color is a very important profit pool. And as a consequence, working with a partner which has deep knowledge, core capabilities and of course, a brand that consumers recognize and value, but also ability to educate the staff of the salons is a very important asset. This is why Wella is today the Number 1 hair salon business in the world. It's a power brand. It's one of the very, very important brand in the industry. And we are recognized for it, and we know that this asset gives us opportunities to again expand geographically.

We are not -- we are very, very present in the western world, but we have opportunities and we are seizing these opportunities in China typically, but also in other markets across the world to expand this brand, but we are going to premiumize and we will innovate behind this brand too.

We also have brands, which have much more equity or much more in our language, we call that mental availability or top-of-mind presence than physical presence. One of the great brands, I'm sure most of the ladies on this room will recognize OPI. This is a brand, which is about $200 million revenues. The equity of this brand is very, very powerful, although the US still represents more than 55% of revenue. The awareness around the world is very powerful. For instance, in many of -- in all our travel retail stores, a shelf of display of OPI is the most productive display that they have in their entire stores around the world.

And on the right side, [ph] there is a brand that we have, ghd, Good Hair Day, can't make this stuff up, is one of $300 million in revenues. It's present only in a few markets. Its Top 5 markets represent 70% of its revenue. It's a brand, which is growing double-digit, and it's a very, very strong business which -- behind which we have a lot of geographic expansion capabilities, leveraging, in that case, the power of our professional sales force around the world.

And finally, we also have in that ability to innovate, and I'll take just an example of something we are doing as we speak, which is the launch of the first professional echo-ethical mind in the Nordics and where we offer our hair care to our professional of salons, a hair care brand with the range of three [ph] natural products, vegan and cruelty-free, 93% to 99.7% of natural origin, 100% recyclable packaging, and it's a market which we estimate will is on the world of about $4 billion, and we will at least double or if not more, during the next five years to 10 years.

So we've seen that we have momentum here. We have capabilities to capture it and again ability through our market presence to capture it. One of the capability gap that we have addressed too over the course of the last two to three years has been our e-commerce business. We have been technically struggling behind that, but however, despite the concerted -- sorry, due to a concerted effort in the business, we have now systematically improved our position in e-commerce, and we're operating now in the high-single-digit and the main gap that we have with our competition on this subject is not in our position per market.

It's the mix of our market, right, which is what creates the gap sometimes with some of our competitors, but as you can tell the growth rate of this business is very strong. Being in luxury, we do expect that, but very strong in professional and we have seen it particularly as a mechanic to drive not only business, but to drive education, which is a very important driver of promotion of our brand going forward in our Professional business, but also in our Consumer Beauty business where we experienced 25% growth. So, I think that we have momentum here. We are building capabilities, and we feel good about what we are doing from a profitability standpoint. It is also an attractive business for us.

So, we think that we have significant value, I mean not only value in terms of monetary value, the value in terms of brand equity, value in terms of core competencies, ability to build the portfolio going forward, and these two divisions represent almost 70% of our EBITDA, our EBITDA being north of $1.3 billion. So, again, I think we are -- we feel good there, and it is not businesses that we have to fix. These are businesses that we have to accelerate. And again, as I said, they represent about 70% of the profitability of Coty.

However, we have places that we need to fix, and we are very knowledgeable of that. And we get reminded regularly in our earnings call over the performance of our Consumer Beauty business. Since coming back, I was happy to see that listening to Bob Gamgort, I was not the only one having subject of business being an area of focus. So that's very good. So we have a path to improvement, and this path to improvement will be about combining what I call discipline and creativity in the organization.

And clearly, we operate in a relatively good business. Yes, it is a business which is in small decline on a worldwide basis, but it is probably a small decline because we don't capture where the growth is. Same conversation again than the one we had with Bob this morning on the cosmetic [ph] business. But also it is a small decline because clearly, the markets in which we are present are a bit under more pressure from that direction standpoint, but even if it is in small decline, it's not a big problem.

What is our objective? Our objective is to clearly capture the fastest growing part of the portfolio. And you can see in that chart, which is an example of the US market, but it happens everywhere around the world. One of the secular trend in our industry is wealth. Consumers have occasionally a bit less money, but in general they have more money over time. And participating into the uptrading of the business is the key to growth even in markets where the category tends to reach degree -- a certain degree of saturation from a penetration standpoint.

You can see in the US -- in the US, sorry, cosmetic market that the value mass is declining, but the mainstream is growing a bit, and what is going fastest is the premium mass. One of the tensions that we have at Coty, we don't have enough premium, right. So we need to rebalance our portfolio, and we will do so going forward. One of the positions also that we have is we have relatively strong market position in Consumer Beauty. As you can tell, in the US, we are the Number 2 player in Consumer Beauty in mass with 20% market share in color cosmetic. In the UK, we are the Number 1 color cosmetic player with 35% [ph] market share. And in Brazil, we are the Number 1 player also in color cosmetics. So

we have asset, right. And we have position that we can harness and that we can build on. So we have a certain number of geographies where we feel strong and we feel in a good position, and these geographies are the mission-critical one that we have talked together when we are doing in our turnaround, we were discussing with some of you our Turnaround Plan.

So what are we going to do with this business? We are going to do a few simple things, but -- which are absolutely vital to deploy. First and foremost, we are going to advertise at scale our key brands. We have isolated 12 global brands behind which we are going to be in top position, plus a certain number of local brands which are mission critical for the market in which we do operate, and we are going to advertise these brands at scale, which means that they will be consistently advertised that they will -- we will continue to build out distinctive assets and we will make sure that instead of having 20% of our advertising money going behind this intersection, key brand market, 60% of our advertising money going forward will go behind this, we call them, DMUs, this intersection, power brands and markets.

The second and take an example of what happens when we do it and when we do it well because not only sufficient to advertise, you need to advertise efficiently and effectively and building on the brand asset. We launched Rimmel Wonder'Luxe, which was a premium innovation that we launched at 12% premium versus the historical positioning of the brand. We didn't support it at the beginning.

We decided -- of course, this is a great product. This launch, we will support it at scale and over a period of time of six months, we moved from 15 of Rimmel in the UK market to Number 5 position -- Number 5th position in the mascara, so in the UK market. Actually, when you are French, Rimmel is mascara, so kind of confused everything. But we moved it from the Number 5th mascara in the UK market to the Number 3 mascara in the UK market and I have absolute conviction that within a year, Rimmel Wonder'Luxe will be the Number 1 mascara in the UK market, right. Why? Because we have a great product. We advertise it. It says we make sure we sell it at the right price. We make sure we display it and it's well executed and it works.

The second thing that we are (inaudible) behind building our brand at scale. We are going to reverse pricing -- historical price decline, all right. You can see how the price index has moved over the years, of course, a different market. We have not dared to take prices. We are lucky enough that we do operate in an industry, which is fairly price inelastic. And as a consequence, we do know that taking pricing is one of the ways, which enable us to be able to advertise our brand at scale, whilst at the same time raising our profitability.

Of course, we have a cost effort into the business, and we will also deploy a cost effort, but we are going to be also very, very committed at making sure that we do not dilute our margin by over-promoting or by not passing to the consumer the cost push that we are experiencing in our business due to inflation, devaluation, you name it.

So, we feel that we have a plan on the matter and we can see a road forward in improving -- not on -- on stabilizing our top line, but also improving our gross margin by doing that.

The third driver that we are going to do, we are going to reduce the number of sub-brands. This business has been having too many sub-brands and of course, these sub-brands are very important distinctive assets that we have for each of our brands. And as a consequence, it is very important that as we not only advertise our key brands at scale, we also advertise our hero sub-brands. They are very fundamental.

They are the one that consumers decide to purchase and recognize the average time to purchase in our color cosmetic, shelf at Walmart is one minute. We don't have a lot of time to waste. And many of our customers make that purchase decision in 30 seconds. So clearly, having clear shelf, having clear sub-brand recognition on the product, making sure that our distinctive assets are well exposing to the store and that the brand is recognized immediately, is quite a fundamental driver of performance.

And finally, we will clear our range. We have far too much complexity in this business. But we will do it wisely. And what does wisely mean? Wisely mean that you need to first identify where are your profitable SKUs. This is an example taken out of one of our market. But we will do that for all our markets around the world. We have already done it for 50% of our turnover. We will make sure that within a period of time of now going forward another year, we will cover our entire market around the world with methodologies.

We will identify all our SKUs on the first axis, which is -- that do contribute to making our gross margin accretive or do they dilute our gross margin. And second axis, which is the most important one to make the decision, do we keep, don't we keep it is, does it contribute to increasing or is it relevant for the brand or does it contribute to increase the penetration of the brand, all right? If it does not and it's margin dilutive, these are the one that we are going to rationalize? And if you do -- if it is not margin -- if it is margin accretive, but doesn't bring a lot more -- in terms of penetration, we will reduce the complexity selectively in that one and the top left-hand quadrant, which is a very important one, are the one which drives penetration or accretive to the share velocity that we have, but yet do not deliver the gross margin. And in that case, we value engineer the product, right. And clearly, we want to have a high portion of our business on the top right-hand quadrant. This is only today -- only 40% of our SKUs. Going forward, we want to make sure that this is at least 60%, 65% of our SKUs over the year as we would not get there immediately; over the years, represent that top heightened quadrant. And as a consequence, it will provide to our customers the velocity that they look for by doing that, and as a consequence, it will enable us to have conversation about sales mix as a result of improving that.

So I think in a nutshell, I feel very confident and we do feel very confident that by keeping the creativity that we have in this organization, whilst at the same time instilling, I would call it, an approach to business transformation based on data, based on analytics, based on understanding of mass behaviors, right, we have a path to success. I feel very, very confident that we do have it. From a personal standpoint, I view this path to success in many, many experiences so far, and it has always worked. I'd be very disappointed if it doesn't work at Coty mostly because I'm massively invested personally in the Company, but also because I personally don't see any reason why it don't work -- it works all the time. I feel very, very confident that we have something that all people get. They actually react very well to this approach, and it enables us to build confidence in the organization and of course, hopefully in you.

Without any further ado, Pierre-Andre will take you through what it means financially, and we'll come back for questions.

Pierre-Andre Terisse, Chief Financial Officer

Okay. Thank you, Pierre. It's freezing here. So I hope you get the sense of excitement as we both have in particular in front of this incredible portfolio of brands. I think you know what Pierre described. That makes us confident in the objective we set for ourselves, the consistent and strong performance of the two divisions, which represent 68% of the EBITDA, being Luxury and Professional Beauty, both in terms of the ability to grow top line and in terms of their ability to grow profitability. The confidence in our ability to improve the Consumer Beauty through the operational issues and to drive them back to a more balanced evolution, all that we focus on consistency, and we believe these three things. So Luxury -- driving Luxury and Professional, fixing Consumer Beauty and being consistent and focused can ultimately and quickly actually build significant value and the value is going to build. We have tried to express it with the targets. We've given ourselves for the next four years, which are on the screen which mean that we intend to bring back growth in this business, low-single-digit growth on the starting point, which is today of minus 3.5%. That was the evolution of sales in 2019 full step-up, which is very meaningful of adjusted operating margin from the current 11% to 15% as midpoint. Step-up in free cash flow as well, which crossed [ph] $200 million this year, and we expect to bring it to $1 billion by 2023, and that's going to have deleveraging the Company. And these objectives are simple, but they're very unique to the action plan described by Pierre. And we believe -- they are going to create a lot of value.

How? Financially speaking, that's the way I'm trying to express what we are trying to do. It's a fairly complex chart, but in reality, not that much. It's the P&L. In fact, what you see on the top of the evolution of net revenues with mix and value, the evolution of COGS on the right side, then the gross margin, the advertising, the fixed cost and the evolution of the operating margin. And basically what we are going to try and do is not only to activate one lever, but to activate many levers at the same time. And then the levers which are not rocket science, but pretty simple. Simply, we will do that with discipline and a lot of methods.

On the right hand side, we have a very precise and ambitious program to reduce our cost. We add that to level of the organization on the fixed cost side with an organization delayering plan, which is going to be implemented as soon as the end of this first half of fiscal '20 for us. We have an ambitious plan in terms of reduction of the cost with productivity on the one hand, where we still have a lot of possibility to deliver cost reduction, but also for what Pierre described, which is essentially a reduction of the complexity by eliminating SKUs, the few SKUs which are not profitable and bringing our effort or putting our effort on SKUs which have the ability to drive penetration and again, reduce the cost overall.

So the cost side is going to be very important. It's going to allow us to address, to reinvest in a very meaningful manner in advertising. We today estimate we have a gap of about 500 bps with our competition -- 500 bps to 600 bps with competition in terms of more leverage in A&CP. We are going to start closing this gap, and we are going to close this gap. Thanks to the cost saving we are making and this is going to help us drive net revenues up gradually from the minus 3.5% to 0% to 2% and hopefully more ultimately with Luxury continuing to grow with Professional Beauty growing at a pace it has to be growing and with Consumer Beauty progressively lending, and that's only lending in absolute terms in terms of its profitability and the gross margin and the average price of this business. And this is going to deliver a gross margin expansion north of 500 bps, which is going to be the main driver of the growth of profitability, of cash flow of this Company in the coming four years, allowing again to reinvest through advertising and delivering an operating income margin of plus 300 basis points to plus 500 basis points on top of the 0% to 2% net revenue increase. That's going to allow free cash flow to get up and net debt to continue decreasing as it has already started doing, and that's going to drive as well a meaningful piece of the EPS.

Talking about the debt, we've done some very significant progress in 2019. That was very important to start the Turnaround Plan in a safe financial situation. A lot of actions that we made. We have no maturity -- no major maturity until 2023, so the debt is secured. The financial conditions have been reversed reworked so as to allow flexibility. And we have started, more importantly, a very big program of free cash flow -- of acceleration of our free cash flow moving into positive territory now and having an ambition of delivering $1 billion through EBITDA improvement of course, but also through a lot of actions in working capital. There's a number of fields in which we have the ability to progress. In terms of capital expenditures, we can make progress in efficiency in terms of management of the inventory as well and that's as well one of the top priority we have.

So that's the plan. That's not the plan for tomorrow. That's the plan for today. In fact, it has already started. Our fiscal year starts on the 1st of July, so since the 1st of July, we are working on the Turnaround Plan. And 2020, so fiscal '20 is going to be the first year of that. Our net revenues, as you heard, was minus 3.5% like-for-like in 2019. We are going to bring it to stable to slightly down in 2020. So it's going to rapidly evolve. The adjusted operating income, we expect to have already a significant progress in 2020 with a 5% to 10% evolution year-on-year with a strong A&CP reinvestment. So we are going to start -- we are starting in fact as we talk today, reinvesting behind our brands with a view to fuel it. This is going to lead to a mid-single-digit growth year-on-year of the adjusted EPS for the first year -- for the start of this Turnaround Plan and to continuous improvement of our free cash flow, which again have already made some meaningful progress in 2019.

So that's our agenda. Again, I hope you feel the excitement. This is a new management team for a company, which is incredible in terms of its brands, incredible in terms of its people, its energy, has been lacking some time a bit of consistency, but we are here for that and we are very committed to unlocking the value which exists in Coty. Thank you.

So I understand there's room for questions. Now, okay if any?

Questions And Answers

Lauren Lieberman, Analyst

So when you reported last week and you talked about the top line outlook for 2020, it sounded to me as though it was a bit more constructive than you had spoken to us previously, stable rather than -- stable to low -- slight decline versus moderating. So I guess one, am I misinterpreting or in fact, are you feeling a bit better? And if so, what are the key elements that are making you comfortable so early in sounding a bit more confident as you speak to all of us?

Pierre Laubies, Chief Executive Officer

I will start and Pierre-Andre will add. I think that first, to be honest the delivery of the response of the organization to this approach to look at the business, right, and to look at the business in, I would call it, relatively objective way. And I think that very often in organization when you spend a lot of time looking for guilty people is not very constructive and not very conducive of stability and energy. And I think today, we have a lot of momentum in the business by people objectively now without any objection being able to reconfigure their plan and abandoning very, very unproductive marketing strategies and sales tactics. So that's one to the response of the organization.

The second fact is that I have been very consistent from the beginning that a lot of our sales decline in Consumer Beauty were very inflicted by the loss of distribution. At a certain point, this loss of distribution will lap, right and there will not be as pronounced as they had been and what clearly makes me having confidence in that or makes us having confidence in that is the fact that very rapidly after we engage in our own -- I would call it in our approach to -- in our path to growth in the Consumer Beauty business. We went to talk to some of our customers, and the response was very positive, right. And clearly, our customers have also an objective, is not to face in front of them a monopoly. So they kind of like competition. And as a consequence, I do think that the level of losses that we have experienced over the course of last year from a distribution standpoint. I'd be very, very surprised if we had the same type of things going forward. Actually, I don't think we will, right. And I have absolute -- I'm French, so I'm very careful, right. And I think the total feedback we have is quite positive on the matter.

Pierre-Andre Terisse, Chief Financial Officer

And maybe to add to that two factors, Younique was probably an element of uncertainty which is no longer present. And the strong end of Luxury is an interesting element. We had a Q4, which was ahead of expectations coming in front of Professional Beauty which was a bit weaker, but for reasons which are one-off and therefore, the combination of the two is slightly ahead of what we thought. That would explain the difference of tone, which is really a difference of tone more than the real change in substance.

Lauren Lieberman, Analyst

I think we can stop there and go to breakout. So thanks so much for being here.

Pierre Laubies, Chief Executive Officer

Thank you.

Pierre-Andre Terisse, Chief Financial Officer

Thank you.